

30 March 1984

MEMORANDUM FOR THE RECORD

STAT

FROM:

SA/DD/Pers/SP

SUBJECT: House Hearing on Supplemental Retirement Program,
28 March 1984

STAT

1. On 28 March 1984, the undersigned and [] (OLL) attended the fifth in a series of five hearings on supplemental retirement scheduled by the House Committee on Post Office and Civil Service chaired by Congressman William D. Ford. This hearing took on a different tone than the previous four in that the testimony generally supported the minority viewpoint of the committee (i.e., Administration proposals) for cutbacks in existing retirement benefits recommending similar provisions be incorporated into the new supplemental program. The previous four hearings were more of a pro retention of benefits by testifiers.

2. Today's testimony was provided by a panel consisting of a representative from the National Taxpayers Union, the U.S. Chamber of Commerce and a senior member from an actuarial and consulting firm (the Wyatt Company). Their formal remarks generally followed the prepared testimony provided in advance to the committee (copies attached). In the case of the representatives from the Taxpayers Union and the Chamber of Commerce, the remarks dealt with the over generosity of the Civil Service Retirement Systems versus retirement plans available in the private sector. They focused on early retirement provisions and the total indexing of the Federal pensions as being the primary reasons for what they considered excessive costs to maintain the Federal retirement program. They also called for amortization of the "unfunded liability" associated with CSRS stating such a situation would be unlawful in the private sector. Various statistics were used to support their remarks and they challenged data previously used by the committee, particularly with respect to average age at retirement data.

3. The presentation from the representative of the Wyatt Company appeared to be less bias and generally more factual. For the most part it was an attempt to provide a clearer comparison of retirement benefits of some larger companies in the U.S. with respect to the Federal program. His comparison did include the point that benefits in the CSRS relative to private practice among larger firms were:

- a. roughly in line for long-tenured late retirees i.e., 65 with 35 years of service.
- b. possibly a bit low for short-tenured late retirees i.e., age 65 with 15 years of service.

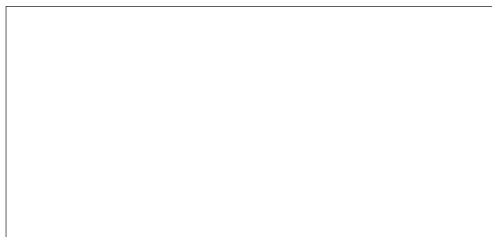
c. clearly more generous for early retirees.

4. Discussion following the testimony generally centered on the validity of statistics and comparisons used to support the testimony of the Taxpayers Union's representatives. At the conclusion of the testimony, only Congressman Ford and Congressman Oakar were present; the only other Congressional representatives attending the hearing were minority members Dannemeyer and Crane, both of whom left shortly after the hearings began. Ms. Oakar stated she thought the comparisons offered between CSRS and Social Security were insufficient and did not delineate enough of the differences between the two systems to be meaningful. She went on to say that more comprehensive data needs to be provided to be objective i.e., differences in employee contribution, vesting, disability, etc. She felt it was dangerous to generalize on comparisons. Specific data used in the testimony by the Taxpayers Union representative were challenged by both Mr. Ford and Ms. Oakar and this appeared justified when that individual could not readily identify the source of his statistics. Ford then chastized the panel members to be careful on the indiscriminate use of numbers.

5. Ms. Oakar spent some of the time dealing with how the recommendations and proposals impact on women, especially elderly women, who make up a large portion of the annuitant population. It is clear that she intends to pursue improving benefits for those individuals or at least not allowing any reduction as activity progresses on this issue.

6. Some discussion then took place regarding the meaning and general importance of the current unfunded liability in the CSRS. Basically the panel members agreed with the D/OPM's contention in previous meetings that the unfunded liability was a problem and jeopardized future benefits. Congressman Ford took his previous approach that it was only a problem if the Government went out of business. He stated the D/OPM and others should stop frightening people with their statements on this issue.

7. This was the last of the currently scheduled meetings and no mention was made of the committee's next activity. However, as mentioned previously in a discussion between [] and the committee Staff Director, the next series of meetings could be sometime in May 1984 when certain heads of Agencies may be asked to testify and present their views on requirements. At the conclusion of this meeting, Ford again alluded to the budget cut imposed on the committee for studying the retirement issue and the possible requirement for extending the study because of that cut.



WILLIAM D. FORD, MICH., CHAIRMAN

MORRIS K. UDALL, ARIZ.
WILLIAM (BILL) CLAY, MO.
PATRICIA SCHROEDER, COLO.
ROBERT GARCIA, N.Y.
MICKEY LELAND, TEX.
DONALD JOSEPH ALBOSTA, MICH.
GUS YATRON, PA.
MARY ROSE OAKAR, OHIO
KATIE HALL, IND.
GERRY SIKORSKI, MINN.
THOMAS DASCHLE, S. DAK.
RON DE LUGO, V.I.
CHARLES E. SCHUMER, N.Y.
DOUGLAS H. BOSCO, CALIF.

GENE TAYLOR, MO.
BENJAMIN A. GILMAN, N.Y.
TOM CORCORAN, ILL.
JAMES A. COURTER, N.J.
CHARLES PASHAYAN, JR., CALIF.
WILLIAM E. DANNEMEYER, CALIF.
DANIEL B. CRANE, ILL.
FRANK R. WOLF, VA.
CONNIE MACK, FLA.

House of Representatives

Committee on Post Office and Civil Service

Washington, D.C. 20515

TELEPHONE (202) 225-4054

COMMITTEE ON POST OFFICE AND CIVIL SERVICE

CONTINUATION OF HEARINGS ON SUPPLEMENTAL RETIREMENT SYSTEM

March 28, 1984

WITNESS LIST

PANEL :

H. P. Mueller, III, Pension Research Consultant, National Taxpayers Union;

Michael J. Romig, Manager, Human Resources and Employee Benefits, Chamber of Commerce of the U.S.A.; and

Sylvester J. Schieber, Director, Research and Information Center, The Wyatt Company.

OPENING STATEMENT OF CHAIRMAN WILLIAM D. FORD (D-MI)

March 28, 1984

Today we continue hearings into the development of a supplemental retirement plan for those Federal officers and employees who, effective January 1, 1984, are covered by social security. This is the fifth in a series which I expect will continue at least into next year.

As a result of the Social Security Amendments of 1983, there are now two distinct groups of Federal employees for retirement purposes -- those covered by social security and those who are not. For those not covered, existing Federal retirement systems remain an appropriate and essential part of the compensation package. But for those who are covered by social security, existing systems are inappropriate. Accordingly, we must develop a supplemental retirement plan to coordinate with social security.

-2-

Our panel of witnesses consists of Mr. H. P. Mueller, III,
Pension Research Consultant, National Taxpayers Union;
Mr. Michael Romig, Manager, Human Resources and Employee
Benefits, Chamber of Commerce of the U.S.A.; and Mr. Sylvester J.
Schieber, Director, Research and Information Center, The Wyatt
Company.

Statement of H.P. Mueller, III
Pension Research Consultant, National Taxpayers Union
Before the Committee on Post Office and Civil Service
U.S. House of Representatives
on
Civil Service Retirement System
March 28, 1984

Mister Chairman and Members of the Committee.

Thank you for the opportunity to testify on the Civil Service Retirement System.

The National Taxpayers Union represents 130,000 dues-paying members who are interested in reducing the burden of government on the American taxpayers. In studying the federal pension issue, we have tried to be as objective as possible in our analyses. However, we will warn you ahead of time that we have a definite slant in our perspective -- and that's from the point-of-view of the American taxpayer, the silent majority whose benefits are modest in comparison to the Civil Service Retirement system, who pay for 87% of the cost of the federal employee plan, and who believe they are not being fairly represented -- at least on this issue -- by the Senators and Congressmen they elected into office.

No doubt in the past few weeks you have heard many compelling arguments from federal employees concerning their pensions. But I doubt that you have heard anything about how the current CSRS is not good for the majority of federal employees or for the taxpayers at large.

As a good employer and a fiscally responsible organization, the federal government should first establish objectives and guidelines for use in developing its retirement programs.

Objective Number 1:

At National Taxpayers Union, we believe that federal employees deserve a fair and reasonable pension for their hard work and dedicated service. At the same time, we believe the federal government, as an employer, has an obligation to ensure at least a minimal level of financial security for all of its employees in retirement.

I would suggest that you and your predecessors, despite your success in creating what many consider to be one of the most generous pension programs ever created, have failed in meeting this most basic objective.

That is because 62% of all current actively working federal employees will leave government service before becoming eligible for Civil Service Retirement benefits. When this majority leaves government service, all they receive is a refund of their 7% contributions, without interest. It is a refund that I suspect many use to buy a new car or take a nice vacation ... but not put away to ensure their financial security in retirement. The bottom line is this ... the current system benefits a few at the expense of the majority.

Objective Number 2:

The federal employee groups and Congress have said repeatedly in recent years that the federal government, as the nation's largest employer, should set an example for other employers.

We agree, but once again, we suggest that Congress has failed.

First, any organization that does not ensure even minimal financial security in retirement for the majority of its employees is a bad example. Any system that benefits a few at the expense of everyone else is a bad system.

Second, a good example is one that is consistent in its dealings and does not favor one group over the others. By letting federal employees retire with full benefits at 55 while increasing the age for full Social Security benefits to 67 and offering even greater penalties for "early" retirement at 62, Congress is letting a double standard operate.

Third, a responsible organization ensures the financial integrity of its retirement programs. It follows the same rules required of other organizations and learns to operate within its own means. The Civil Service Retirement System does not have to meet the tough ERISA requirements imposed on private sector businesses. It is not limited by the amount of money held by a trust fund like Social Security. That's a double standard, and that's why the federal government is not living up to its longstanding objective of serving as an example for other employers.

Objective Number 3:

Objective number 3 relates to the Committee's question about our views on comparability analysis.

We believe that the norm of society should be the governing principle in setting federal pay and benefit levels. By this we mean:

Comparability on a total compensation basis ... with an honest comparison with the private sector.

For wages and salaries, the norm for comparison should be the average for all businesses in the private sector. We believe the data base used in the Hay Associates analysis is too narrow. It should include smaller businesses. We suggest that a sample of businesses, large and small, including state and local governments, and representing a broader array of jobs be used for comparability purposes. This kind of comparison would comply more correctly with the provisions of Section 5301, Title 5 of the U.S. Code, which says: "Federal pay rates be comparable with private enterprise pay rates for the same levels of work." My reading of Section 5301 does not restrict the comparison to only the largest private sector corporations.

Secondly, for comparability, we recommend a retirement system for federal employees based on the norm for the private sector. This means mandatory Social Security for all current and future federal workers; a supplemental pension program fully paid by the government with an employer normal cost of no more than 8% of payroll; and a system that fully meets all ERISA guidelines.

Thirdly, the comparability analysis should consider a fair evaluation of other employee benefits. It should recognize that federal health benefits are not as comprehensive as private sector plans, while also indicating that federal vacation and sick leave policy is more liberal. Similarly, it should recognize that stock options, profit-sharing, bonuses, expense accounts, company cars, and free parking are the exceptions -- not the norm -- in the private sector.

Objective Number 4:

The government should encourage savings, investment, and greater self-sufficiency. To meet this objective, we recommend a voluntary optional thrift plan in which federal employees can contribute up to a certain percentage of their salaries -- say 6% -- and have the government match it 50 cents on every dollar they contribute, up to a maximum of 3%.

General Design Considerations

In focusing on these objectives, we've touched briefly on some general design considerations for a new Civil Service Retirement System. Let's look at this question in more detail.

For current federal employees hired before January 1, 1984, we recommend transferring everyone -- except those age 50 and over and with 20 plus years of service, or any age but with 25+ years of service -- into a new Social Security-based system. Credit the 7% contributions these employees have already made to the CSRS to Social Security. Since the CSRS's employee contribution rate has been higher than the Social Security rate, the added amount that federal employees have paid could be invested in a thrift plan, with a 50% match from the government.

For those over the age and service requirements, allow them to remain grandfathered in the present Civil Service Retirement System, but with the following modifications: (1) Offer cost-of-living adjustments at 70% of the annual change in the Consumer Price Index; (2) Raise the normal retirement age for full benefits to 60 while allowing retirements as young as 55, but with an actuarial reduction of 6-2/3% -- the same rate as Social Security -- for each year under 60.

For new employees hired after January 1, 1984, place them in a Social Security-based program like the one mentioned for current employees. For both groups offer a supplemental pension offering the following characteristics:

- * Paid entirely -- except for Social Security and the thrift plan -- by the government;
- * Costing no more than 8% of payroll for the supplemental pension -- a rate that, according to your consultants, Hay Associates, is comparable to amounts paid on average by the firms they survey each year;
- * Incorporates actuarial reductions for early retirement;
- * Provides no cost-of-living adjustments other than the annual increases offered by the Social Security component;
- * Follows all ERISA requirements.

From a taxpayer perspective, we would prefer to see a defined contribution type plan ... simply because it is fully funded at all times and the government can precisely determine its costs.

If a defined benefit program is developed, we recommend a system that is fully integrated with Social Security. High income employees should receive greater replacement rates from the supplemental plan than those at the lower end to compensate for the tilt in Social Security benefits. From our point of view, all employees who retire at the same ages and with the same years of service should have the same replacement rates regardless of their salary levels.

As with a defined contribution plan, the total employer cost for the supplemental pension should not exceed 8% of payroll. This would mean a normal retirement age for full benefits of 65; retirements as young as 55 but with actuarial reductions of 4% per year under 65; cost-of-living adjustments equal to one-third of the annual change in the Consumer Price Index, with a cap of 5%.

Eligibility and Inflation Protection

You asked for our viewpoints concerning the adequacy and equity of individual benefits.

There are many misconceptions about the generosity of CSRS benefits. To clear away the smoke, we used two approaches for comparing benefits.

We took the actual pension formula for the CSRS and matched it against the benefits formula for Social Security and a typical Fortune 500 company pension. We took two employees who were identical in all respects except that one worked for the federal government and the other, for a Fortune 500 company. Both retired in 1974 with "high 3" salaries of \$15,000. Both retired after 30 years of service. Note that we retired them in 1974 -- that allowed us to illustrate 10 years of actual cost-of-living experience.

Starting at age 55 in 1974, the federal retiree received \$8,558; the private sector worker, just \$2,700. Seven years later, at age 62 when the private sector retiree begins receiving Social Security, the federal retiree was up to \$16,163; his private sector counterpart was receiving just \$7,448. For the first ten years of retirement -- using actual cost-of-living adjustments -- the federal retiree received \$131,043; the private sector retiree, just \$42,446 ... less than one-third the amount. If these individuals live out their normal life expectancies and if we have 5% inflation for the remaining years, the federal retiree is projected to receive \$402,702 in benefits during 21 years of retirement; the private sector counterpart, just \$157,808.

Another way of comparing benefits is to look at individual components of the pension system ... at items like normal retirement ages and cost-of-living adjustments.

In the private sector, 65 is the normal retirement age for full benefits from Social Security. As you know, Social Security permits early retirement as young as 62, but only with a 20% penalty. And last year, Congress passed a provision that would raise the retirement age for full benefits to 67 by the year 2027 while increasing the penalty for early retirement at age 62 to 30%. The average Social Security retirement age is between 63 and 64.

There is a variety of data on retirement ages reported for private sector plans. According to the Bureau of Labor Statistics, the normal retirement age for corporate pension plans was 65 for 45% of the plans; 19% had ages between 61 and 64; only 10% had ages between 56 and 60.

As you know, a federal civilian employee can retire with full benefits at age 55 after 30 years of service. In 1982, 36% of all new retirees who took optional retirement went out under the 55/30 years of service provision. Since this committee brought up the question of equity in benefits, I am certain the American taxpayers would be interested in learning why federal employees should be permitted to retire at such young ages while those in the private sector must wait until age 65 to get similar full benefits.

The typical answer has been that the average retirement age for federal employees over the past 10 years has been 61.1 years while the average for private sector workers has been 61.5 years. That comparison, unfortunately, has been accepted at face value by many. Let's look a little closer at those statistics.

The 61.1 federal figure is a 10 year average for the period 1973 to 1982. The 61.5 year private figure is for 1978 only.

In addition, the 61.1 federal figure is for optional retirement only. It does not include disability or involuntary retirements, provisions that have significantly lower average retirement ages. However, that 61.5 private sector figure does, in fact, include disability retirement. Thus, we are comparing apples with oranges.

Let's look at how an objective, unbiased analysis would compare the data.

Looking at optional retirement only, the average for new federal retirees in 1978 -- the only year private sector data was available -- was 60.8. The average for the private sector normal retiree was 64.7 ... a 3.9 year difference, not the 0.4 year difference suggested by the misinterpreted data.

If you want to consider all types of retirement -- including disability -- and use the much quoted 61.5 figure for the private sector average retiree, the comparable federal average becomes 58.4 ... a 3.1 year difference.

Thus, proper interpretation of the data clearly shows that federal employees do, in fact, retire at ages significantly lower than their private sector counterparts.

For cost-of-living adjustments ... both the CSRS and Social Security provide COLAs equal to 100% of the change in the Consumer Price Index. But saying that the inflation adjustments are the same is like comparing a watermelon with a peanut.

That is because a 10% increase on \$12,432 (average non-disability CSRS annual pension in 1981) is much larger than a 10% increase on \$4,632, the average Social Security non-disability annual benefit in 1981. Even though both may receive the same 10% increase, the federal retiree takes home \$760 more in hard dollars.

A study of corporate pensions by Hay Associates showed that in 1981 only 8% of the firms it surveyed had formal annual cost-of-living adjustments in their pension plans. However, of that 8%, all but one-half of one percent had annual caps of 4% or less.

Another study by the Bureau of Labor Statistics showed that only 3% of the plans it surveyed had COLAs in their normal pension formulas.

Other studies have shown that most private plans offer irregular or ad-hoc adjustments to provide some relief from inflation. When averaged over the long-term, these periodic adjustments amount to 1/3 the annual change in the Consumer Price Index. When all of this is combined with Social Security, the total effect is an annual private sector adjustment equal to about 70% of the change in the Consumer Price Index.

When we ran that 1/3 CPI assumption through our computer model for the age 55 retirees, we found that the private sector 21 year total increased from \$157,808 to \$176,302 ... still considerably lower than the \$402,702 total for the federal retiree.

Financing

The final area you asked for our comments was in financing. You noted that the current funding is less stringent than imposed on private systems by federal law. You are right ... ERISA would not permit a half-trillion unfunded liability like you have today for the CSRS.

However, you suggested that the funding is more advanced than Social Security. Perhaps that is so, but Social Security is not shored up by general revenue appropriations. Social Security is limited by the total amount of money available in the Social Security trust funds; Civil Service has free access to the pocketbooks of every man and woman working in America.

Let's talk about unfunded liabilities.

No pension plan in America, other than the federal plans, has access to general revenues. The CSRS does. In fact, 87% of the money flowing into the system comes from the American taxpayers ... better than 50% of whom are not vested in any pension plan whatsoever. Take away that general revenue appropriation, and the current Civil Service fund dries up in less than five years. Is that financial soundness?

You ask about financial aspects of the system? ... let's look further.

During the 22 year period from 1960 to 1982, while outlays for Civil Service benefits rose 2101%, the number of federal retirees increased only 273%. Who paid for this significant increase in benefits? The answer is clear ... while taxpayer contributions rose 2667%, federal employee contributions increased only 449%.

The trends become even more disconcerting when compared to other economic factors.

Many say that the 1288% increase in Social Security outlays precipitated the system's recent fiscal crisis. But 1288% is nothing when compared to the 2101% increase for Civil Service. Everybody is talking about out-of-control federal spending and deficits. But during that 22 year period federal budget outlays increased only 690%, a rate far faster than the 504% jump in Gross National Product. Some federal employee groups point to inflation as the cause. But during that 22 year period, inflation rose only 225%.

So, when you hear that the Civil Service Retirement System is financially sound and solvent, keep the taxpayer perspective in mind and think about those strict funding requirements you impose on the rest of America.

How can the CSRS be brought up to acceptable funding levels? Very simply. Amortize the unfunded liability of the current system over an extended period, say 40 years. Use dynamic assumptions in calculating the unfunded liabilities. Reduce all benefits so that the normal cost for the government, as employer, is about 14% to 16% of payroll. Use a defined contribution approach for the new systems so that the plan is fully funded at all times. Finally, include all federal employees -- except those nearing retirement -- in the restructured system.

In closing, I would like to go back to the issue of whether a restructuring of the current system represents a breach of contract with the federal employees.

According to the U.S. Supreme Court, it does not.

So the ball is in your court.

We would suggest that Members of Congress have a more sacred contract with the American taxpayers who voted them into office to assure the responsible stewardship of their tax resources. We would also suggest that you have a sacred contract with the majority of federal employees who will never receive Civil Service retirement benefits. Their well-being should not be sacrificed so as to give extravagant benefits to the few.

We encourage you to develop a supplemental pension for new federal employees and to modify the current CSRS as we have suggested. Make certain that you receive an honest comparison to private sector benefits, one that compares apples to apples. We encourage you to use us as a resource in your further deliberations.

Thank you.



Statement of the Chamber of Commerce of the United States

ON: FEDERAL EMPLOYEE PENSIONS

TO: HOUSE POST OFFICE & CIVIL
SERVICE COMMITTEE

BY: MICHAEL J. ROMIG

DATE: MARCH 28, 1984

TESTIMONY
on
FEDERAL EMPLOYEE PENSION
before the
HOUSE POST OFFICE & CIVIL SERVICE COMMITTEE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
Michael J. Romig
March 28, 1984

My name is Michael J. Romig. I am manager of the Employee Benefits and Human Resources Policy Center of the U.S. Chamber of Commerce. The center is responsible for developing positions on employee benefit issues for the Chamber. I appear here to express the Chamber's views on how to revise the federal employee pension system as a result of the decision to require new federal employees to participate in Social Security.

We are pleased to have this opportunity to participate in a unique and historic opportunity to address the needs of the federal government's largest and most expensive employee benefit program--the civilian pension programs provided to over 2 million employees. As Committee Chairman William D. Ford indicated, Congress faces a difficult, but not impossible, task of redesigning the civilian pension system to accommodate the Congressional decision of 1983 to gradually phase the federal civilian workforce into Social Security. In so doing, Congress, under the leadership of this committee and its Senate counterpart, must carefully balance the needs and wishes of two distinct groups of federal employees and weigh this against public demands for a less costly retirement system. Also to be considered is the government's need for a pension system that is manageable, nondiscriminatory and complementary to its employee recruitment and retention policies. Although this appears to be a mission impossible, we think it can be accomplished and we are happy to share our thoughts on how to do it.

-2-

We also wish to compliment the members of this Committee for their decision to approach this responsibility in a carefully considered and deliberative manner. Retirement is a major component of federal employees compensation package and a significant cost to taxpayers. More importantly, it represents the nation's largest pension program providing significant retirement income protection to millions of retired Americans and many millions more to come.

SUMMARY

The Social Security Amendments Act of 1983 set the stage for Congress to address a myriad of problems plaguing the federal civilian retirement program. The task of designing a new supplemental pension program for all federal employees who began their employment since January 1, 1984 can and should be the first step toward bringing order to what heretofore has been a chaotic pension system for federal employees. Rather than design this new system to match the much criticized existing civilian retirement programs, we recommend that focus be placed on comparability with the private sector. Then this new program would serve as a benchmark for bringing comparability to existing programs.

THE CHALLENGE

With the enactment of Public Law 98-21, the stage was finally set for addressing a myriad of problems that have plagued the federal retirement system for several decades. The litany of complaints, documented by a number of commissions, boards and others, revolve around three findings:

1. Unfunded liabilities (i.e. the estimated future cost of all accrued pension benefits) now exceeds \$1 trillion for all federal--civilian and military--pensions. That is an IOU legacy from us to our children and their children and it will grow unless we take steps to stop it.

-3-

2. Federal pensions are seen as much too generous when compared to those in the private sector.
3. Federal retirement programs lack an overall, coherent, coordinated policy that treats employees equally and recognizes the legitimate interests of management and taxpayers.

All three can now be addressed as we proceed to implement a new federal retirement program for all who entered federal service since January 1, 1984. Indeed, as we see it, there is no way to avoid responding to these complaints if we are to win both taxpayer and employee support for the new system.

Therefore, our recommendation to you is to design a pension program for new employees recognizing that changes in the existing retirement programs will also be necessary. Without such changes, public pressure to scrap both new and existing programs will intensify as costs continue to escalate and the gaps in comparability widen. Clearly, the preferred course is for Congress to design and develop a new overall civilian retirement system that is responsive to all considerations rather than acquiesce to abrupt changes responsive to annual budget considerations only.

NATIONAL RETIREMENT POLICY

Our nation's retirement policy envisions a three prong approach to meeting retirement income needs. First, there is to be a national system (Social Security and Medicare) that will meet basic needs and is earned through a career of employment. Because it is national in scope, it should apply to all employments and be portable from job to job. Currently, the largest gap in this protection is federal employees.

The second component is to be employment related pensions designed to complement Social Security's floor of protection. That is the primary mission of this Committee.

-4-

The third component is to be personal savings and capital accumulation fostered by tax policies that reward savings and investment.

We fully endorse this policy and continue to believe it is in everyone's interest to bring current federal employees into Social Security. There is no compelling rationale for not doing so.

FEDERAL RETIREMENT POLICY

Looking at the existing hodgepodge of federal retirement systems, the disinterested observer would correctly conclude that there is no overall policy for federal pensions. Over 100 separate pension programs are maintained providing various groups of employees with inconsistent and differing benefits.

This Committee and Congress must use this opportunity to correct this situation both for new and current employees. We recognize that special retirement provisions may be justified for particular groups. For example, some would argue that the nature of the Foreign Service requires different treatment. However, the overall policy must emphasize that all federal personnel receive comparable and consistent benefits, absent a strong showing for special treatment.

COMPARABILITY

In addition to comparability among federal personnel, this Committee and Congress must strive to make federal pensions comparable to those in the private sector.

While there is a dispute over how to measure comparability, it can not be disputed that few private pensions match the generosity of most federal pension plans. As the President's Commission on Pension Policy noted, federal pensions in almost all respects are more favorable to the employee than are private pensions. Much of this disparity is traceable to the following:

-5-

- . federal pensions provide unreduced early retirement benefits to a much greater extent than private plans;
- . federal pensions provide full annual protection against inflation, whereas private plans offer only partial protection;
- . federal pensions generally have more generous benefit calculation formulas than private plans; and,
- . the federal government does not have to fund its pensions on the same basis as the private sector.

The Chamber's overall policy goal is for full pay and benefit comparability. Achievement of this goal may be best achieved by seeking to match benefit for benefit and pay for pay. Hence, it would be our recommendation that you focus primarily on retirement comparability for purposes of this task, recognizing that future endeavors would require examination of other benefits and pay matters.

In offering this suggestion, we fully understand that overall benefit and pay costs can not be ignored entirely. But to attempt to resolve all disparities while resolving the pension dilemma will only mire Congress in a succession of debates. On this point, we agree with the Administration's observation that the differences are too pervasive to make a total pay and benefits overhaul practical in one package.

Our final recommendation on comparability is to use a broad cross section of private industry to make the comparison. Our own annual survey, a copy of which I have provided members of the Committee, includes a larger number of smaller firms than other studies. Because of the large number of people employed in small firms, a comparison that excludes these firms will be quickly discredited. Similar considerations apply for including local and state government pensions in the comparison.

-6-

GENERAL DESIGN

You have asked us to comment on the general design of the supplemental system. Although we have not presented specific options to our policy committees and our Board of Directors, certain factors are going to be very influential in our deliberations on what kind of plan should be adopted. We think that they should weigh in your considerations as well.

(1) Defined Benefit vs Defined Contribution

The options are a defined benefit or a defined contribution plan, although a combination of the two can be selected. A defined benefit plan promises to pay a specified retirement benefit to all employees who meet the plan's service requirements. Most private sector plans aim for 50 percent of final average pay (last 5 years) for employees with 30 or more years of service. A lesser period of service produces a smaller pension while more years of service adds to the pension.

A defined contribution plan promises to make a specified pension payment for each year of service. The longer the years of service, the greater the pension. Under these plans, the actual annuity depends on how much has been accumulated and how much that amount can provide under market conditions at the time of retirement.

In the debate over which pension plan to choose, a fundamental point is often obscured. The point has to do with the difference between pension plans (defined benefit plans) and other forms of benefit plans (defined contribution plans) that can supply retirement income.

In a defined benefit plan, the employee is relieved of the risk of investment losses. That risk falls upon the employer who must make sure that his contributions and the investment earnings on them will be sufficient to pay the promised pension. If they are not, the employer must add funds from current earnings or other company assets. In the case of federal pensions, that obligation falls on the taxpayers.

-7-

In a defined contribution plan, the employee bears the risk of total contributions and earnings on them adding up to an adequate pension. If earnings are good, the employee can count on a handsome retirement income. To hedge against poor earnings, larger contributions are generally made, if at all possible.

By the same token, although the employee under a defined contribution plan gets the benefit of investment gains, the employer under the defined benefit plan gets the benefit. In each case, the risk taker enjoys the rewards or suffers the consequence.

In essence, the trade-off is this: the employee in a defined benefit plan has security; the employee in the defined contribution plan is at risk. Under a defined contribution plan, an employee may make out far better than a similarly situated employee in a defined benefit plan, but he also may make out far worse. To put it another way, the employee under the defined benefit plan is entitled to a specific benefit. His security in that benefit is backed up by the company that sponsors the plan.

A defined benefit plan primarily serves the longtime employee and does little for the short-term employee, since the latter does not remain with the employer long enough to become vested. Because the current civil retirement system is a defined benefit plan, only 25 percent of those who enter the civil service ever draw retirement benefits. So, from an employees' perspective, a strong case can be made for switching the existing system to a defined contribution plan. Since the new employees will participate in Social Security, the case for a defined contribution plan would not be as strong since the portability of Social Security coverage assures accrual of some retirement credits by short-term employees .

From the taxpayer's perspective, defined contribution plans have other factors to recommend them. Chief among these is that such plans do not accumulate unfunded liabilities. With over \$1 trillion in federal liabilities, knowledge that the new system would not add to that burden would be persuasive.

-8-

A combination plan is seldom found in the private sector beyond the very largest firms or among professional or highly profitable small firms. In these cases, the employer attempts to balance the interests of both short and long term employees.

(2) Eligibility and Participation

Private sector eligibility and participation rules are governed by ERISA and most private pensions simply meet these relatively liberal rules. We see no reason why the federal government should use a different set of standards.

(3) Inflation Protection

Cost-of-living adjustments (COLAs) have been a major cost factor for federal pensions and any change to the program must come to grips with this issue. Currently, we are advocating a one year freeze on all COLA's and indexing at 60% of the Consumer Price Index (CPI) thereafter. But even that is more generous than private sector plans. A recent Department of Labor study revealed that private pensions, on average, were able to match only 39% of CPI increase between 1973 and 1979.

(4) Financing

As indicated earlier, the financing of federal pensions is not comparable to the private sector. Perhaps it need not be since there is less chance of the federal government terminating its pensions for financial reasons than might be the case for private firms. Nonetheless, a \$1 trillion funding shortfall is staggering to contemplate. Certainly, it will hamper our efforts to curb inflation and eliminate deficits in the years ahead, but we must make a commitment to amortizing that liability. This commitment will also indicate to all current and future federal retirees that they need not fear for the fiscal integrity of their retirement plan.

-9-

(5) Coverage

As indicated at the outset of our statement, we are convinced that all federal employees should be covered by Social Security.

CONCLUSION

We are here today to deliver this message: The time for reform of federal pensions is at hand. The task begins with the design of a government-wide supplemental civil service retirement plan that is comparable to private sector pension plans rather than the overly generous existing civil service pension plans. This new system must be made to serve the interests of all new civilian employees, their managers and the taxpaying public. We pledge our support to your efforts to implement such a program.

Thank-you.

A
STATEMENT ON
FEDERAL CIVILIAN RETIREMENT PROGRAM DESIGN

by
Sylvester J. Schieber, Ph.D.*
Director, Research and Information Center
The Wyatt Company

before the
House Post Office and Civil Service Committee

March 28, 1984

*The views in this statement are those of the author and do not necessarily reflect the views of The Wyatt Company or any of its other associates or employees.

Mr. Chairman, I am pleased to appear before the House Post Office and Civil Service Committee to present some background information that might be helpful in your consideration of a federal civilian retirement program to be coordinated with Social Security. I am the Director of the Research and Information Center for The Wyatt Company, an actuarial and consulting firm that specializes in the design and analysis of pension plans and other employee benefit and compensation programs. Earlier in my career I served as Deputy Research Director of the Congressionally mandated Universal Social Security Coverage Study and, in that role, I spent a considerable amount of time evaluating ways the federal civilian retirement program could be coordinated with Social Security. My comments today are my own and should not be construed as representing the position of The Wyatt Company or any of its other employees.

Rather than trying to sketch out any specific retirement proposals or plan designs that you may wish to consider I want to focus today on the standard retirement plan designs that prevail in the private sector. I have attached to my testimony a paper I did during February 1983 for the Society of Government Economists. This paper addresses some broad conceptual issues you will have to consider in selecting a general approach to plan design when you finally take up the task in earnest. I did this paper while I was Research Director at the Employee Benefit Research Institute.

In the current discussion I am going to restrict my analysis of existing private retirement policy to large plans. I realize some analysts argue that the federal retirement system should be designed in consideration of all retirement systems, not just those sponsored by large employers. My impression is this position is motivated by the perception that small employer pension plans are not as generous as larger plans. If that is the case it is certainly not reflected in the funding data in table 1.

Table 1

PENSION COSTS AS A PERCENT OF WAGES AND SALARIES
BY PLAN SIZE

Number of Participants	Pension Contributions as a Percentage of Labor Costs
1-10	37
11-25	14
26-100	12
101-500	7
<u>Fortune 500 firms</u>	7

SOURCES: Fortune 500 data from Johnson and Higgins; data for small plans from American Society of Pension Actuaries, "Analysis of Characteristics of Small and Medium Size Employer Sponsored Private Retirement Plans," in a Report to the President's Commission on Pension Policy, 1980. These data were cited in Sophie M. Korczyk Retirement Income Opportunities in an Aging America: Pensions and the Economy, (1982) p. 28.

The whole question of whether small plans are more or less generous and whether they should be included in comparisons with federal retirement plans misses the point. If the goal is simply to minimize federal retirement generosity, then all federal retirement programs should be eliminated. But that is not a realistic or socially desirable goal. It is not even a goal of the most vocal critics of federal pensions. A more rational approach is to recognize the federal government's position and competition in the overall U.S. labor market. If the federal government is to heavily skew its wage compensation or retirement benefit programs against prevailing market practices it is going to affect the hiring and retention of an adequate workforce to perform its mission.

Private Sector Retirement Provisions

The Wyatt Company annually conducts two surveys that are widely used to help design and modify ongoing retirement plans throughout the private

sector. The first is a detailed survey and analysis of the salaried pension, thrift/savings and profit-sharing plans in 50 of the largest U.S. industrial companies as determined from Fortune list published each year. The Wyatt Company has been doing the Top 50 Survey since 1968.

The Top 50 Survey deals primarily with pension plans covering U.S. salaried employees. The survey includes illustrative retirement benefits which reflect benefits payable to employees retiring currently under the companies' qualified pension plans. In addition, benefits for hypothetical future retirees are estimated. The survey also includes a list of other plans which are complimentary to the pension plans offered by the participating companies. The provisions of the thrift/savings and profit-sharing plans are outlined.

The second survey that The Wyatt Company has conducted each year since 1967 is a Survey of Actuarial Assumptions and Funding. This survey includes a sample of pension plans covering 1,000 or more active participants. In the 1983 survey, 727 plans participated. While most of these plans are smaller than those covered in the Top 50 Survey, there is some overlap in the two studies. The Actuarial Assumption Survey provides a broader sample for evaluating certain plan characteristics than the Top 50.

Both of these surveys include substantial detail that you may wish to consider in your deliberations over a retirement program designed for federal civilian workers hired after January 1, 1984. While neither of the most recent surveys reports has yet been published I would be glad to make them available to the Committee when they are. Both should be published within the coming month. In the remainder of this section of my testimony I will attempt to summarize some of the details from these two surveys that I think you might find pertinent.

Types of Plans. New plans being established today in the private sector tend to be predominantly defined contribution plans.¹ Under these plans the employer makes a contribution to a fund in behalf of an employee. Those contributions and accumulated interest can either be taken as a cash distribution on employment termination or can be converted into an annuity at retirement. While defined contribution plans may be most prevalent, about 70 to 75 percent of all private sector pension plan participants are covered by defined benefit plans. Under a defined benefit plan the employer promises the worker a specific benefit at retirement. The level of the benefit is usually related to length of service and earnings level.

Among the largest 55 industrial firms that we have surveyed this year for the development of the Top 50 Survey only two of the firms had a defined contribution plan as their primary retirement program. Of the 50 large firms with defined benefit plans included in the survey, however, all also offer defined contribution plans which can be considered complementary to the benefits provided by their basic plan. In fact, in 39 of the firms, more than one supplemental plan is offered.

The most prevalent supplemental plan among the Top 50 participants is a thrift/savings plan. These plans typically allow employees to save up to 6 percent of their salary which is then matched by the employer. While several large employers match the employees' contributions dollar for dollar, a 1977 Bankers Trust Study of thrift/savings plans suggests that the most common employer matching rate is 50 percent. Over the last couple of years many

¹This is a relatively recent phenomenon. Prior to the passage of ERISA the number of newly established defined benefit plans consistently exceeded the creation of defined contribution plans. For a detailed discussion of this phenomenon see Sylvester J. Schieber, "Providing Income Security to the Elderly: The Role of Programs Other than Social Security," in Contemporary Policy Issues, (Number 3, April 1983) pp. 33-52.

employers have modified their thrift/savings plans to include 401(k) income deferral provisions. While the employer does not match the portion of the worker's compensation that is deferred in this instance, there is a clear tax incentive that encourages participation. Of the 39 employers with thrift/saving plans in the Top 50 Survey, 26 companies include 401(k) provisions. Thirty-seven of the companies offer stock ownership plans. Six companies sponsor profit-sharing plans. Five of the six profit-sharing plans permit employee contributions, and three include 401(k) provisions in the profit-sharing program.

Employee Contributions. The above discussion implies that the supplemental plans prevalent in the private sector are largely a cooperative retirement saving effort by the employer and employee. In the thrift/savings plan, the employee must typically contribute to get the employer match. Through the profit-sharing plan, employees are encouraged to be industrious so there will be profits to be shared. Even the stock ownership plans are structured to bring the employee into a position of sharing in the corporate fate. While the thrift/savings or 401(k) options may be relevant for your considerations, it is unlikely that either the stock ownership or profit-sharing plans bear much relevance in this instance.

The primary pension plans sponsored by large employers are much less likely to require employee contributions than their secondary plans. In the 1984 Top 50 Survey, 39 of the plans have no employee contributions. One company allows voluntary employee contributions but these are not subsidized. Of the ten plans requiring employee contributions, seven have integrated their contribution schedules with Social Security. The typical contribution rate in the integrated plans ranges from 2.5 to 3.5 percent on earnings above \$12,000 to

\$15,000. In the plans requiring contributions that are not integrated the contribution rates are 2 percent of salary or less. Thus it is clear that in most cases private sector workers do not have to contribute to their primary pension plan, and where they do, the contributions are seldom more than a couple percent of salary.

Vesting. The one area in which the current Federal Retirement program is clearly inferior to private sector plans is in its vesting provisions. In fact, the Federal Civil Service Retirement System would be in violation of the ERISA vesting standards applied to private plans. Under ERISA a vested benefit is a commitment that must ultimately be paid in one form or other. A private sector pension plan sponsor can make provisions for cashing out the vested benefits for workers who have terminated employment prior to retirement eligibility. Alternatively the plan can defer benefit payments until the retirement eligibility criteria are met. In the case of the private plan, however, the withdrawal of any employee contributions to the plan would not lessen the plan sponsor's obligation to pay vested accrued benefits under the employer's segment of the plan. In the case of terminating federal workers who withdraw their own contributions after the five year vesting standard is met, the Federal Government's obligation to pay the vested benefit is liquidated by the employee's withdrawal. Such practice would be a violation of ERISA statutes for a private plan.

On the surface, private sector vesting practice may appear to be more harsh than the current five-year vesting provisions that are part of the Civil Service Retirement System (CSRS). Forty of the Top 50 Survey plans provide for full vesting after ten years of service. Six additional plans also have ten year vesting in combination with an alternative vesting schedule for special

cases (e.g., full immediate vesting for workers attaining age 55 if the other standard has not been met). Four plans include a graded vesting schedule that begins prior to ten years of service. Thus the prevalent vesting practice in large private retirement programs may be somewhat more stringent than the federal civilian retirement program in their tenure requirements, but vesting is significantly more meaningful in the private plans. Since as many as 80 percent of all vested federal workers who terminate employment prior to retirement eligibility withdraw their own contributions from the CSRS, vesting is almost meaningless in the current federal program.

Retirement Provisions. One area where the CSRS has been criticized is in the provision of unreduced retirement benefits at a relatively early age. For example, a full benefit is paid to workers attaining age 55 with 30 years of service under the civil service program. The criticism of this provision often focuses on the unavailability of unreduced Social Security benefits prior to age 65. While the CSRS retirement provisions are more generous than Social Security's, large private pension programs also frequently treat early retirement more generously than does Social Security in terms of early retirement benefit reductions.

Among the plans participating in the Wyatt 1984 Top 50 Survey, all but three plans provide unreduced benefits under some circumstances at age 62. Every one of the plans permits retirement by age 60, with 26 plans providing for unreduced benefits under certain circumstances by that age. Retirement at age 55 is not available under four of the plans in any circumstances. Thirty-five additional plans provide reduced benefits for workers retiring at age 55. The remaining eleven plans provide unreduced benefits but only in certain instances (e.g., age plus service equal to 80).

Similar information was gathered on a much larger and more diversified sample of plans in Wyatt's 1983 Actuarial Assumptions Survey. The results based on the characteristics of the 727 plans surveyed are shown in figure 1. In this case, 50 percent of the plans do not pay full benefits prior to age 65. Only 18 percent of the plans provide unreduced benefits prior to age 60. While 64 percent of the plans provide full or subsidized retirement benefits prior to age 65, less than one-fifth of the plans in this sample provide unreduced benefits at age 55 in any event. Similarly only 22 percent of the Top 50 plans provide unreduced benefits as early as age 55 and only 14 percent pay an unreduced benefit at age 55 with 30 years of service.

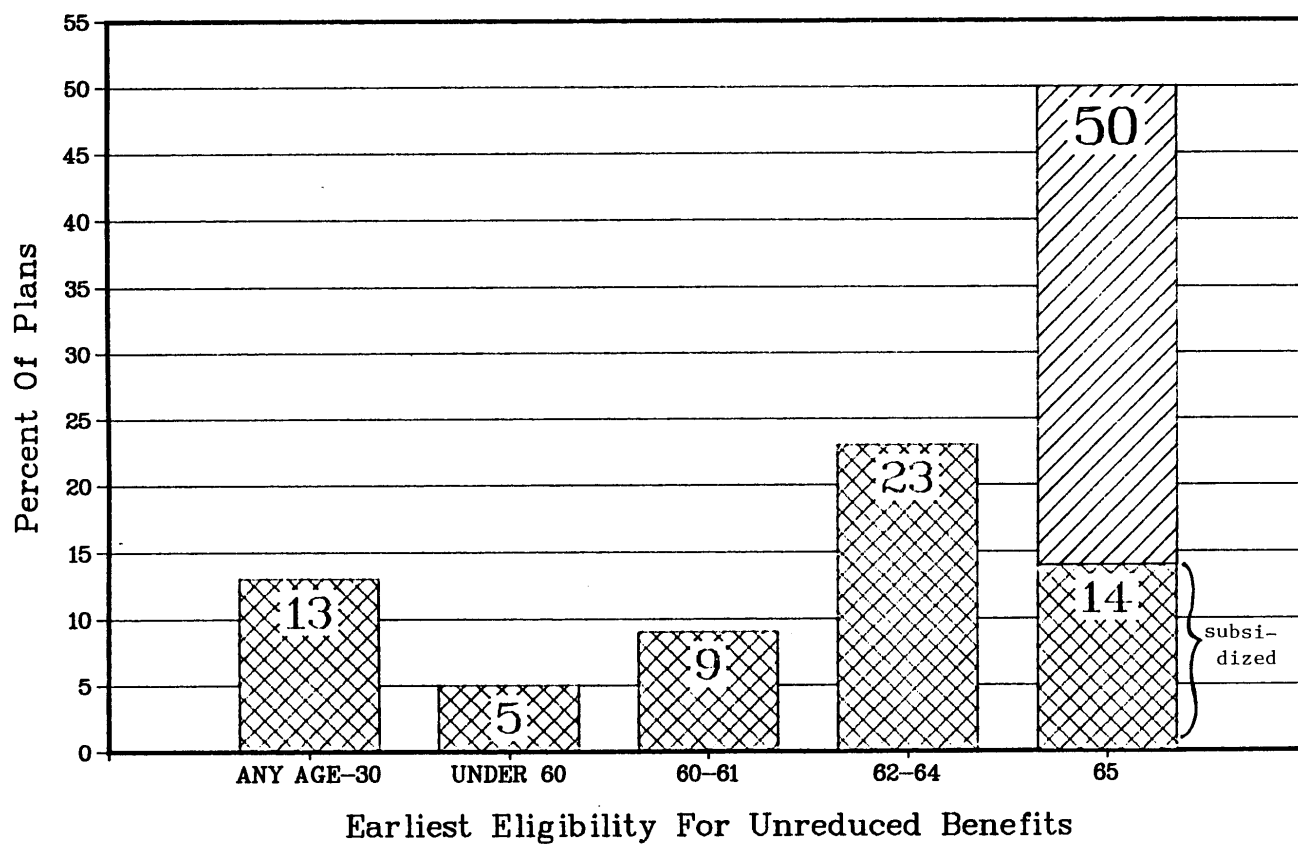
Benefit Levels. Pension benefits are often examined in terms of the portion of pre-retirement earnings that they replace. In this fashion the relative generosity of plans can be compared for individuals with similar work tenures and salary histories. For purposes of developing such benefit comparisons in the Top 50 Survey a salary of \$35,000 was assumed for 1983. The historical pay schedule for purposes of benefit determination were based on the assumption that the person's pay had increased at the rate of the national average, plus 1 percent. The final salary assumed here is roughly comparable to that of a General Schedule Grade 12, Step 5 or 6. Choosing a higher or lower earnings profile might affect benefits marginally but would not radically change any conclusions that might be drawn from this analysis.

Given the diversity of age and service combinations that precede retirements under any pension plan, a large number of plan comparisons could be developed. To simplify matters, only three are presented here.

The first comparison considers a hypothetical worker retiring with 35 years of service at age 65. This long-tenured, late retiree's benefits were estimated under the current benefit formula for each of the plans included in

Figure 1

EARLY RETIREMENT BENEFITS
IN WYATT 1983 ACTUARIAL ASSUMPTION SURVEY



The Wyatt Company

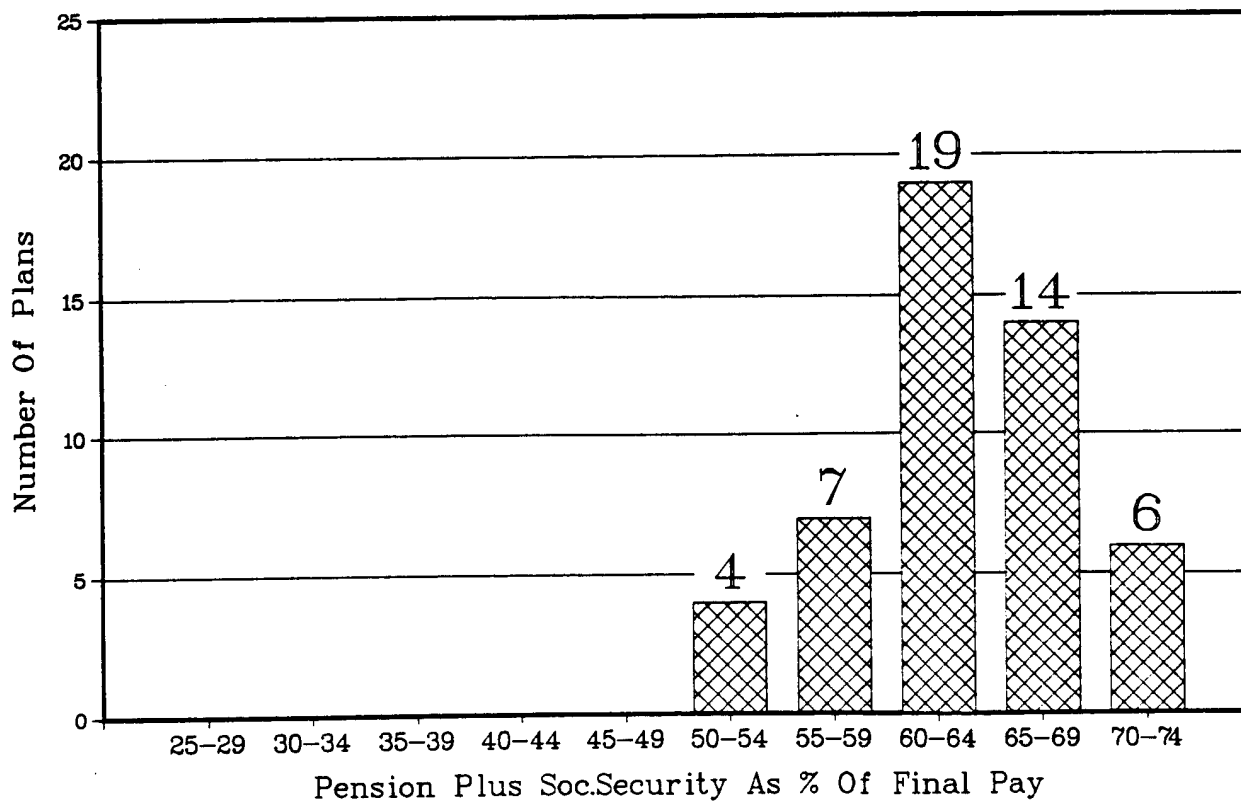
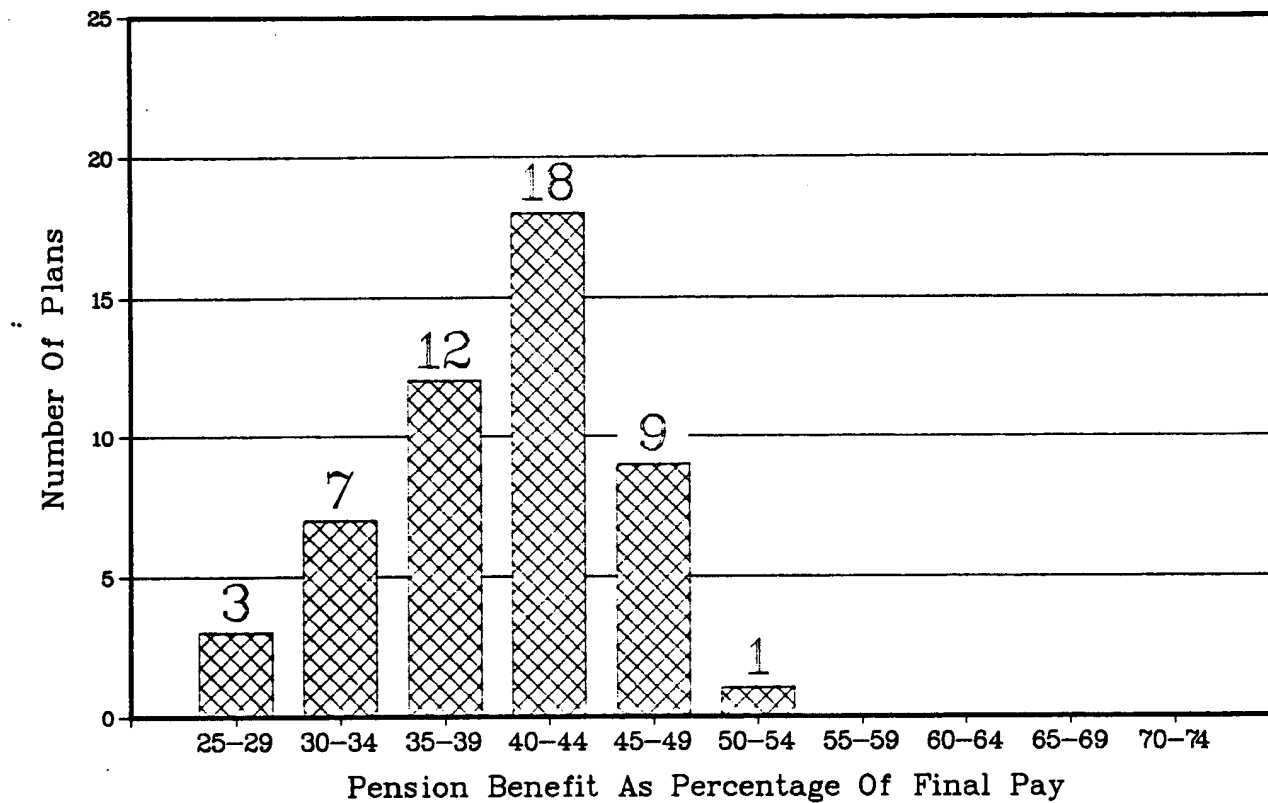
Wyatt's Top 50 Survey. The results are shown in figure 2. The top graph in the figure shows the portion of the last year's gross earnings replaced by the pension plan alone. The bottom graph shows the combined pension and Social Security replacement of pre-retirement earnings. It is significant to note that the CSRS would replace about 62 percent of this person's pre-retirement earnings. On the basis of initial benefits alone, the CSRS benefit would not appear overly generous in comparison to large private plans for a full career worker retiring at age 65.

The second comparison considers a hypothetical worker retiring with 15 years of service at age 65. This short-tenured, late retiree's benefits were also estimated for each of the Top 50 plans and the CSRS. The results are shown in figure 3. The CSRS would replace 24.5 percent of the person's pre-retirement earnings, placing him or her toward the top of the pension replacement ranking alone, but at the bottom if both the pension and Social Security is considered. It should be kept in mind, however, that anyone with this age-tenure combination did not enter the employ of the final employer until age 50. Stated alternatively, such a CSRS retiree could have had up to 30 years of Social Security coverage in other career jobs. If that was the case with the CSRS retiree, he or she would undoubtedly have a relatively full Social Security benefit to complement the CSRS pension.

The third comparison considers a hypothetical worker retiring with 30 years of service at age 55. This person's benefit comparisons under the various Top 50 plans are shown in figure 4. The benefits shown here include all early retirement subsidies and supplementation available under the various plans. The CSRS would replace 52 percent of the last year's earnings, placing the federal plan significantly above any of the others included here.

Figure 2

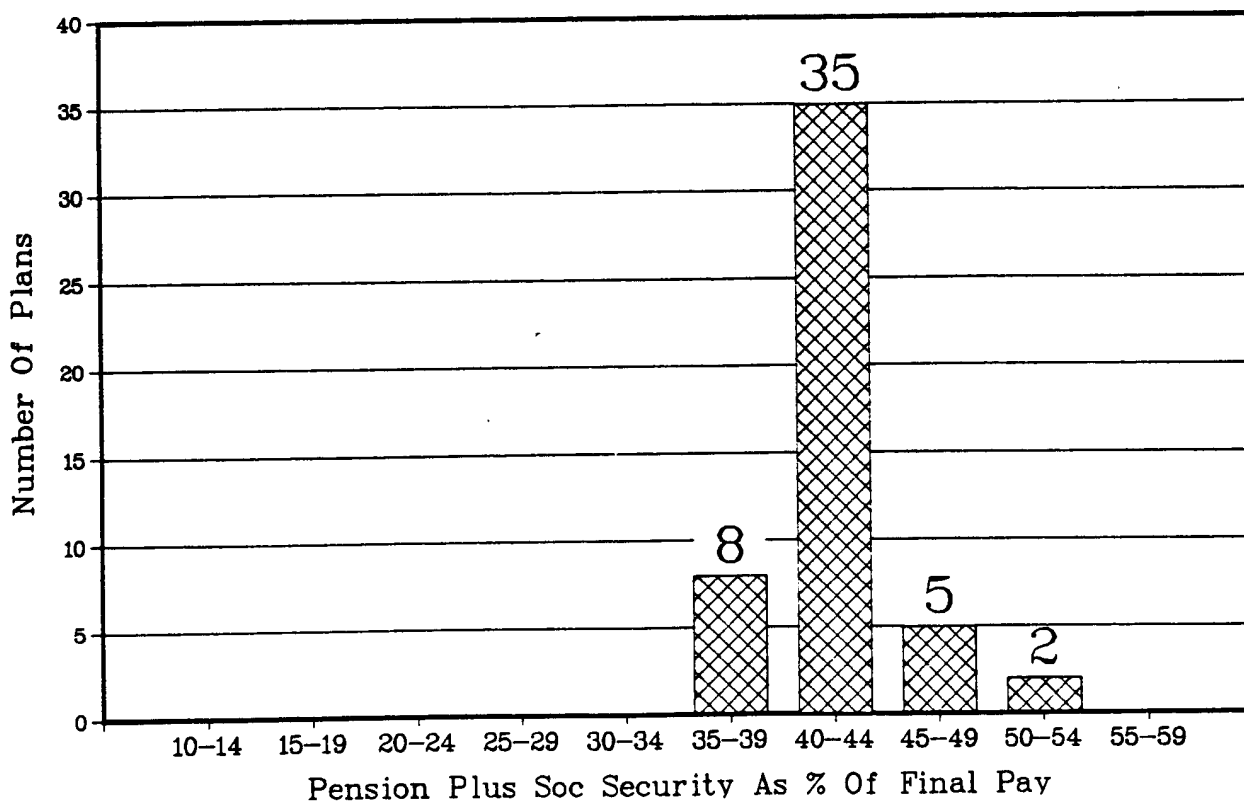
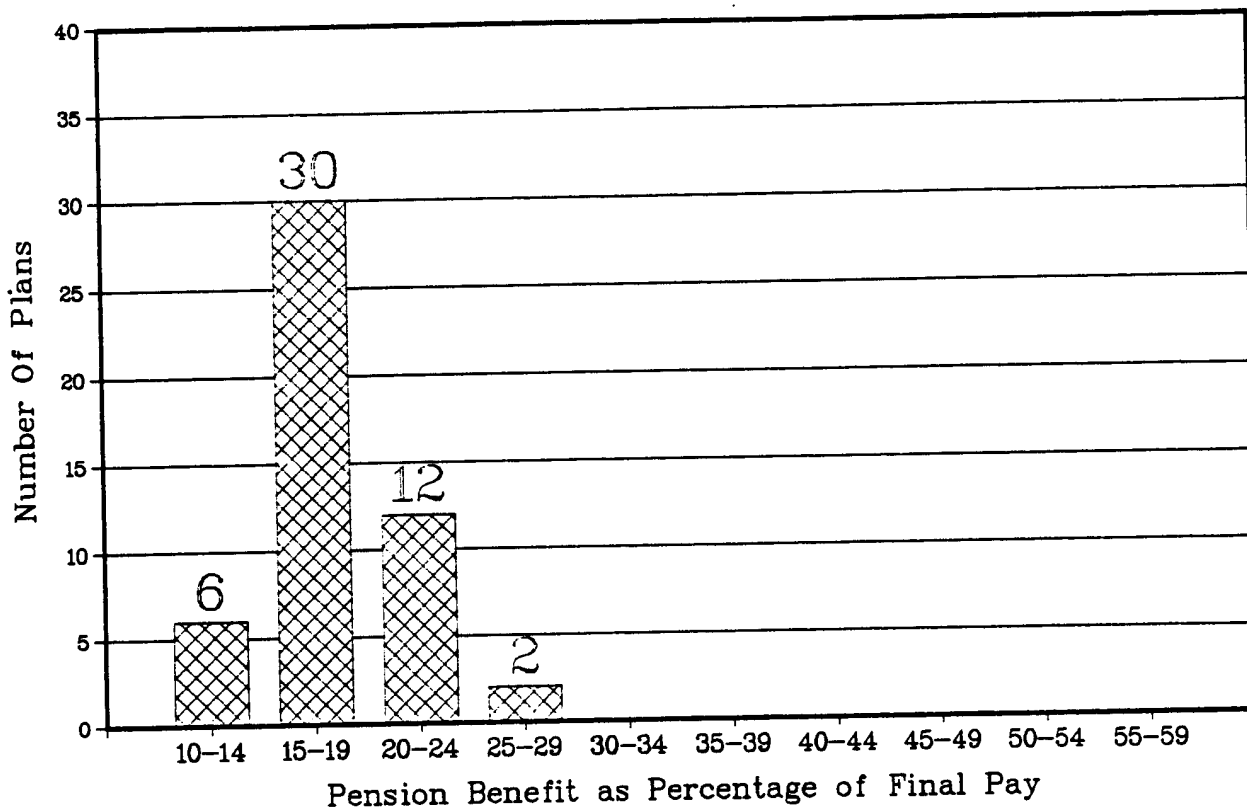
CURRENT RETIREMENT
AGE 65 WITH 35 YEARS OF SERVICE



Source: The Wyatt Company, Top 50 (Wash., D.C., 1984).

Figure 3

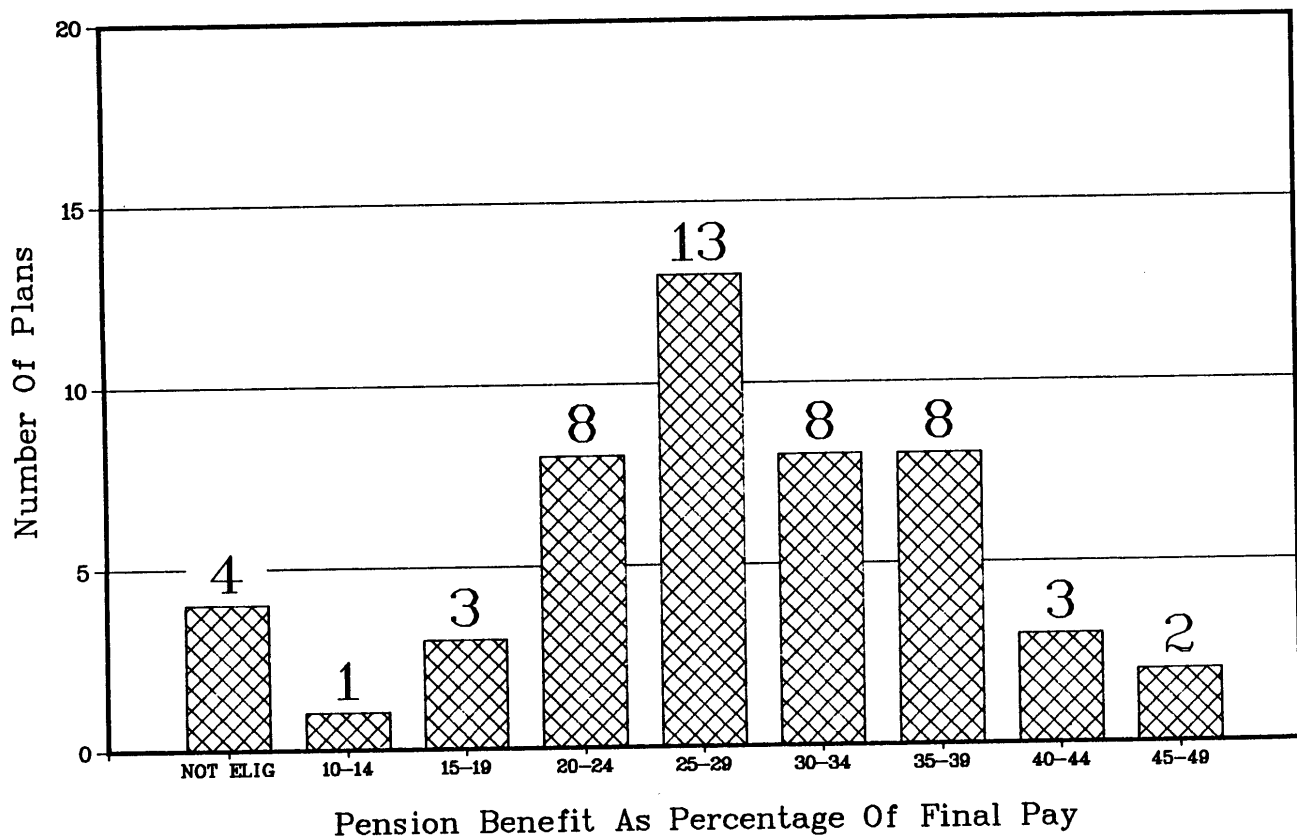
CURRENT RETIREMENT
AGE 65 WITH 15 YEARS OF SERVICE



Source: The Wyatt Company, Top 50 (Wash., D.C., 1984).

Figure 4

**EARLY RETIREMENT
IMMEDIATE BENEFIT AT AGE 55 WITH 30 YEARS OF SERVICE**



Source: The Wyatt Company, Top 50 (Wash., D.C., 1984).

The benefit comparisons above suggest that the existing CSRS initial benefit structure relative to prevailing practice among large private-sector employers is: (1) roughly in line for long-tenured late retirees; (2) possibly a bit low, but indeterminant for short-tenured late retirees; and (3) clearly more generous for early retirees. Focusing on initial benefits, however, gives an incomplete picture of the true comparability of benefits provided by the various programs. When an individual retires, on average, they can expect to live and receive benefits for several years, even as many as twenty or thirty years or more. The relative generosity of plans, then, must be judged on the basis of benefits paid over the full period of retirement. This means that post-retirement benefit increases must also be considered.

Private-sector plans have been much less likely to provide full Consumer Price Indexation (CPI) of benefits after retirement than the Federal Government. Over the last ten years 46 of the Top 50 companies have provided some indexation of retirement benefits. Nearly two-thirds of the plans have given three or more increments over the ten years. During the period of high inflation toward the end of the 1970s the increments tended to occur every other year. Since 1980, with the economic slowdown and reduction in inflation the reductions have come less frequently. It should be kept in mind that during the ten year period considered here Social Security benefits were fully indexed. Thus it would be unfair to simply contract of private pension indexation to CSRS benefit indexation in comparing the effects of inflation on the respective groups of retirees.

In the consideration of a federal retirement program coordinating benefits for workers covered by Social Security, the extent of post-retirement indexation of benefits should be carefully considered. It is clear that

individuals living near subsistence should not be subject to the vagaries of inflation. The inflationary erosion of benefits in such cases can literally become a matter of life or death. At the same time, the social merit of fully indexing benefits for upper middle income beneficiaries should be weighed against the tax burden this implies for middle and lower income workers.

To a certain extent, the prevalence of secondary defined contribution plans in the private sector is a substitute for the post-retirement indexation of benefits. Meaningful benefits from these programs, however, require sustained participation by the workers in most cases. It would be worthwhile to carefully consider this structure of combined plans that is so prevalent among large private employers, and to an increasing degree, smaller ones as well. The cost of such combined benefit programs is more readily controllable than a fully indexed single benefit program.

The two particular facets of the current CSRS program that are so dissimilar to private plans, namely their relative generosity on early retirement and full post-retirement indexation, are two of the most costly facets of federal retirement. If there is any hope that the newly modified federal civilian retirement program is going to cost roughly the equivalent of large private sector retirement programs, then the current early retirement provisions and full indexation will have to be modified. This is not to say that early retirement options will have to be eliminated, nor does it mean that there would be no post-retirement benefit indexation.

Conclusion

The question of plan design is one that every employer establishing or modifying a pension plan must consider. Most employers embarking on such an endeavor look at the world around them, especially the labor market in which they function, for guidance in the development of their plan. If their total compensation package is too generous they cannot maintain their operations. If compensation is too low they cannot maintain a workforce. Similarly, if the relative distribution of compensation is heavily skewed against worker compensation and toward retirement benefits, then the ability to hire and maintain a competent workforce will be limited.

The current federal civilian retirement program appears to be out of synchronization with prevailing pension practice within the labor market in which the Federal Government must operate. Over time that will adversely affect the government's ability to hire and retain high quality workers.



DEFINED BENEFIT OR DEFINED CONTRIBUTION:
WHICH IS BETTER FOR THE CIVIL SERVANT?

by

Sylvester J. Schieber
Research Director

Employee Benefit Research Institute

This is a preliminary draft. The paper should not be cited or quoted without the permission of the author. The views in this paper are those of the author and do not necessarily reflect the views of the Employee Benefit Research Institute, its Trustees, members, or other staff.

EMPLOYEE BENEFIT RESEARCH INSTITUTE

1920 N Street, NW / Suite 520 / Washington, DC 20036 / Telephone (202) 659-0670

The Social Security legislation now being deliberated by Congress will have significant effects across society. Among most of the working population it will mean higher payroll taxes, at least in the short term. For beneficiaries it will mean a delay in cost of living adjustments and for some, taxation of part of their Social Security benefits.

Among the other changes, new federal workers hired after January 1, 1984 will be covered by Social Security. This means that a new or modified federal retirement plan will have to be devised which will coordinate federal retirement benefits with Social Security. There are several practical and political questions that must be addressed in the derivation of that plan. While there will ultimately be a substantive debate over the level of benefits to be provided by the Federal retirement plan, funding procedures for the plan and a host of other particulars, the first decision that has to be made is on the type of plan that will be offered. This paper presents some of the traditional arguments for selecting one or the other of the two traditional types of pension plans.

BACKGROUND

The earliest retirement program in this country can be traced back to 1636 when the settlers at Plymouth Colony decreed "that any man sent forth as a soldier and returned maimed should be maintained by the colony during his life." The colonies made similar provisions for men who were disabled and for survivors of men who were killed in military expeditions against the Indians.

The first national pension law, which dates back to 1776, provided half pay for life, or during disability, for soldiers disabled during the Revolutionary War. Military pensions based on service date back to 1780. Gradually, service pensions came to be provided separately for veterans of each war. In 1862, the first major nondisability program provided for voluntary retirement of military officers after forty years of duty. In 1885, nondisability retirement was extended to Marine and Army enlistees, providing voluntary retirement after thirty years of service. 1/

Civilian retirement programs in this country date back to the end of the eighteenth century. In 1794 Albert Gallatin established the first recorded profit-sharing plan in his glassworks in Pennsylvania. New York City established a pension system for its policemen in 1857. A smattering of additional local public pensions were started during the remainder of the nineteenth century. In 1911 Massachusetts established the first state retirement program for public employees. About a dozen private pension plans existed in 1900; the number grew to about 60 by 1910, 270 by 1920, and 420 by 1930. 2/ The Federal Civil Service Retirement System began in 1920.

Early on, pensions were established for many of the same reasons they are still being established today, including employers' desires to encourage retirement of older workers so younger ones could move up the organizational ladder, and employers' desires to entice superior workers and discourage excessive turnover by providing an attractive compensation package.

1/ Office of the Actuary, Defense Manpower Data Center, Valuation of the Military Retirement System: Fiscal Year 1980 (Washington, D.C.: U.S. Government Printing Office, 1981), p. 1.

2/ M. W. Latimer, Industrial Pension Systems in the United States and Canada (New York: Industrial Relations Counselors, Inc., 1933).

Most of the early pension plans provided no benefits prior to age sixty-five, and they often required twenty or more years of continuous service prior to retirement. Some of the early plans included restrictions prohibiting the hiring of workers over forty-five to fifty-five years of age. Many of the early pension plans were "final-pay" plans, which provided annual benefits equal to 1.0 to 1.5 percent of final average pay for each year of service.

By the mid-1970s private pension funds held billions of dollars in assets. Occasional cases of inadequate funding, poor administration and embezzlement received wide publicity. To remedy these problems and to increase pension participant and beneficiary rights, Congress enacted the 1974 Employee Retirement Income Security Act (ERISA). This legislation does not require employers to adopt employee pension programs. Where voluntary plans are established, however, they must comply with extensive reporting and fiduciary requirements and minimum standards of coverage, participation, vesting and benefit funding. ERISA also created the Pension Benefit Guaranty Corporation to ensure a level of vested benefits when defined benefit plans terminate.

Under ERISA, private employer pension plans generally must provide coverage on an indiscriminatory basis to all employees age 25 or older with one or more years of service. Employers must also adopt a vesting schedule that satisfies one of three vesting standards. One standard requires total vesting after ten years of service. The other two require phased-in vesting after a designated period of service or a specified combination of service and age, and full vesting after fifteen years of service.

Though ERISA established extensive minimum requirements, employers continue to have considerable flexibility in determining many plan design

aspects. For example, private plans can be defined contribution, (i.e., contribution amounts are predetermined while benefit levels are variable and dependent on the total contributions and earnings in each employee's account). Conversely, private plans can be defined benefit, (i.e., benefit levels are determined in advance and contributions are variable but must be sufficient to satisfy promised benefits). In both instances benefit levels generally rise with increases in an employee's wages and length of service.

It is clear that the Federal Government does not have to comply with the pension laws or regulations that it propagates for private sector plans. The current CSRS, for example, is in clear violation of the funding and vesting standards in ERISA. However, for the purposes of this analysis, it is presumed that certain ERISA standards would be met by the modified federal retirement plan regardless of the type of plan (i.e., defined benefit or defined contribution) that is put in place. It is assumed that participation in the federal retirement plan would begin at the point of hire, as is generally the case with the current plan. It is assumed that as in CSRS the plan would have a five year vesting provision but that it would comply with ERISA vesting standards relative to employer contributions to the plan. Simply, this means that once an employee becomes vested, he or she would ultimately be entitled to a benefit.

COMPARING THE GENERIC ALTERNATIVES

Both defined contribution and defined benefit plans are organized retirement plans. Without inferring who actually bears the incidence of program costs, most of these programs are largely supported by employer contributions. From the employee's perspective either type of plan helps provide income security in retirement. From the employer's perspective either

helps in the orderly recruiting, maintenance and retirement of the necessary workforce.

The defined benefit plan provides a clearly stated retirement income level generally related to years of service and a measure of salary toward the end of employment tenure. The defined contribution plan, on the other hand, provides for specified contributions to an individually allocated investment account. Without comparing the actual level of benefits provided to specific individuals under one plan or the other, the two types of plans can be compared from an equity perspective. In this regard Trowbridge argues:

That the employer contributes the same percentage of pay for every covered employee is a philosophical strength of the defined contribution arrangement. The underlying principle of equity is that individual workers enjoy benefits of equal value.

In defined benefit pension plans, as in most group insurance arrangements, the principal is one of equal benefits. Equal benefits are rarely the same as benefits of equal value, because employees vary as to age, sex, and other risk characteristics.

In summary, defined contribution plans define individual equity in terms of equal employer contributions and accept the necessarily unequal benefits that equal contributions provide. Defined benefit plans define equity in terms of equal benefits and accept the necessarily unequal employer contributions. 3/

In addition to these equity differences that apply under the ceteris paribus conditions, there are other differences in the two approaches to pension provision that arise because other things are not always equal. These

3/ "Defined Benefit and Defined Contribution Plans: An Overview," in Economic Survival in Retirement: Which Pension Is for You? (Washington, D.C.: The Employee Benefit Research Institute, 1982), pp. 3-34.

arise partly because of the inherent differences in the two types of plans, but also because of tradition and the differential treatment of the plan types under the tax and regulatory code.

PLAN DIFFERENCES

The relative desirability of a defined benefit versus a defined contribution plan depends a great deal on the goals the plan is supposed to meet. If everyone's goals coincided, then an ultimate plan design could be arrived at easily. There are several players concerned about the design of a new federal retirement plan who do not have coincidental goals. Therefore, they need to evaluate the relative merits of the two major approaches to see if a consensus can be attained on a general approach. In order to reach such a consensus some of the differences in the two retirement plan approaches should be considered.

Defined benefit (DB) plan are often preferred because they can provide retrospective credits whereas defined contribution (DC) plans are prospective. This is especially the case at the time the plan is established if there are workers with several years of tenure who will be covered by the new plan. This ability to grant past service credits is particularly attractive where an employer is offering a pension for the first time. This is not the case with the federal government but may be important if current workers are given the option and encouraged to transfer to the new program. It is also important in the case of benefit enhancements. Under DB plans such enhancement can be granted on the basis of prior service. With a DC plan this is far more complicated, if not practically impossible.

An important reason that it is difficult to provide such retroactive protection under a DC plan is that employers do not typically keep lifetime

historical earnings records on which such a benefit increase would be based. The most important reason, however, is because of the different funding procedures used in the two approaches. The DC plan by nature is always fully funded, although a federally sponsored plan might be somewhat unique in this regard. To grant retroactive credits under such a plan could require a crushing contribution to fund such benefits. The DB plan, on the other hand, would allow the creation of an unfunded liability that could be amortized over several years. While it is impossible to project the likelihood of future benefit enhancements in a new federal retirement program, the CSRS has a long history of gradual benefit improvements that have been granted retroactively.

A second difference between DB and DC plans is that they are structurally different. This is important because it affects the participants' understanding and attitudes toward the plan. In the DB plan the participants can be educated to understand that their benefits will replace a closely estimated percentage of their final earnings and that the pension in combination with Social Security will maintain an estimable portion of the preretirement standard of living. The DC plan provides a clearly perceptible growing account balance. A problem that many workers have is in comparing the relative values of the two types of plans. The defined benefit is stated in flow terms while the defined contribution is a stock.

The stock and flow differentials in the two plan types can be easily reconciled by actuaries and economists. For the individual worker the stock concept may be more easily understood during the period of accumulation, but it is the flow of income that is important in retirement. A person's standard of living is largely determined by the flow of goods and services they can consume over time. While the defined contribution accumulation can be converted to an

annuity at retirement most workers cannot readily estimate the extent to which their preretirement earnings will be replaced until the end of their career. In part, this is the result of the arithmetic involved in converting stocks to flows. It is also the result of uncertain projections of the stock values which themselves are subject to inflationary and market forces that are not always understood.

The latter point relates to a third difference between DB and DC plans. In the defined contribution plan investment performance directly affects the level of benefits. Because contributions and interest accruals relate to specific persons, the risk of adverse market performance is borne by the individual worker. Under the defined benefit plan, on the other hand, the individual is promised a level of benefits related to final salary. Adverse market performance can reduce the value of the pension portfolio as in the case of the DC plan. However, the employer has guaranteed the benefit and has to adjust contributions to make up for bad investment performance.

There are also traditional differences between DB and DC plans that have evolved because they are perceived differently by workers. The perceived accrual of a capital stock in the defined contribution plan raises the employee's consciousness of the value of accumulating assets. The accumulated value of the asset is also much more portable than a vested defined benefit promise. The individually assigned assets can be liquidated and reinvested in an individual retirement account, making them highly portable. This combined perception of a definable asset, along with relative portability may combine to account for typically shorter vesting in DC plans. For the highly mobile worker, the defined contribution plan may be preferred because of its portability characteristics. For the long-term stable employee, on the other

hand, the primary concern is likely to be an adequate level of benefits to maintain preretirement earnings standards. This will more likely be assured through a defined benefit plan. Most defined contribution plans do not have automatic provisions to convert the accumulated assets to an annuity at retirement. The more typical cash-out provisions in these plans are often criticized because it is feared the accumulated funds are often not used for retirement income security purposes. It is the conflicting goals of different workers, employee groups, employer and public policy goals that makes selecting one type of plan over the other difficult.

COMPARING SPECIFIC PLANS

During 1978 and 1979 a study of feasibility and desirability of mandatory coverage of federal workers under Social Security was conducted in accordance with a Congressional mandate included in the 1977 Social Security Amendments. This study was carried out by a special study group staff set up within the Department of Health, Education and Welfare (now Health and Human Services). This study group staff worked directly with compensation and actuarial staffs at the Office of Personnel Management. They also worked with the policy staff in the Office of the Secretary at HEW and received additional support from the Social Security Administration. The final report of the study group 4/ was reviewed by the Departments of HEW, Treasury and Labor as well as the Office of Personnel Management and the Office of Management and Budget.

In conducting their analysis the study group with the aid of OPM staff developed a series of supplementary pension plans that would coordinate the

4/ Final report of the Universal Social Security Coverage Study Group, The Desirability and Feasibility of Social Security Coverage for Employees of Federal, State and Local Government and Private, Nonprofit Organizations (Washington, D.C., 1980).

federal retirement program with Social Security coverage of federal workers. The study group focused entirely on the defined benefit approach as the fundamental basis for the new plan designs. The reason for this was that the study group was directed to devise a coordinated retirement program that replicated, to the extent possible, the benefit structure of the current CSRS program.

In theory, the structure of the current retirement program could be maintained by full integration of the newly modified federal retirement plan with Social Security benefits provided to those covered. This strategy would establish a 100 percent offset of Social Security retirement benefits. The existing CSRS benefit formula would be retained, but the resulting benefit would be reduced by the full amount of Social Security benefits attributable to Civil Service employment. The purpose would be to maintain intact, the benefit structure of the current CSRS by neutralizing completely the redistributational effects of Social Security benefits. Social Security would provide proportionally higher benefits to employees with relatively low incomes, and the CSRS would pay proportionally higher benefits to high-income employees. A 100 percent offset approach would cost about the same as the current CSRS. The main problems with this approach are that it would be administratively complex, would require a complicated and potentially inequitable attribution of Social Security benefits, and is contrary to IRS regulations on pension integration. 5/

The strategy that the study group pursued was to design retirement

5/ See James H. Schulz and Thomas D. Leavitt, Pension Integration: Concepts, Issues and Proposals (Washington, D.C.: The Employee Benefit Research Institute, 1983) for a complete discussion of the integration rule.

programs similar to those that prevail in existing Social Security covered employment. The overall plan designs that were developed provided average benefits that were roughly equivalent of those provided by the current system. Because of the redistributive nature of Social Security this approach would result in an increase in retirement benefits for lower income employees and a reduction for higher income employees.

One way to reduce the effects of this redistribution of benefits relative to the current system would be to offer a "thrift plan" that subsidized employees who saved for their own retirement. A thrift plan would provide an optional, contributory, supplemental annuity for individual employees. Employee contributions could be matched fully or in part by the government, with the accumulated contributions and investment earnings collectible upon retirement. High-income employees, who would have substantial earnings above the Social Security tax base, could use this option to obtain replacement rates comparable to those now produced by CSRS. The costs to the Government of a thrift plan would depend on the specified matching rate and the level of employee participation. The study group estimated that a thrift plan in combination with the modifications of the CSRS they considered would cost approximately the same as the current CSRS.

The study group devised three retirement models. The first would stand alone relative (i.e., add on) to Social Security; the second would provide a basic federal retirement benefit offset by some percentage of the annuitant's Social Security benefit; the third was a two-tier (i.e., step rate) benefit formula that would provide an increasing rate of income replacement as average salary increases. It should be noted that both the offset and step rate approaches tend to soften the redistributive nature of Social Security.

However, in neither case would they completely neutralize it.

The study group's add-on plan is used in the following analysis to compare the relative benefits provided by a defined benefit plan in comparison to a comparably expensive defined contribution plan. The add-on defined benefit plan devised by the study group was chosen for this analysis because it is simplest given that the benefit can be computed independently of Social Security. This plan was not selected because it is considered superior to any other option being considered. It was chosen simply because substantial background analysis was already available on the structure and cost of the plan. The benefit formula for the study group's plan would provide 1.15 percent of the high three consecutive years' average salary times years of total creditable federal service. There was also an early retirement supplement in their plan design which is not discussed in this analysis.

The analysis of the various plans that the study group devised included detailed cost estimates of the various elements of their plans. The estimate of the normal cost of only the retirement benefits provided by their add-on plan was roughly 14.5 percent of payroll. The normal cost is the percentage of a worker's salary that would have to be set aside each year to fully fund that worker's retirement benefits by the time he or she retires. The average normal cost for all workers is the normal cost of the entire retirement system. The estimate that the normal cost of all retirement benefits provided by this plan would be 14.5 percent of payroll is not to say that is the normal cost for each and every worker. Also the 14.5 percent estimate does not include the cost of disability or survivor benefits. The value of retirement benefits only is included because it allows an uncomplicated comparison of the benefits provided by a defined benefit versus a defined contribution plan for federal workers.

Under both plans it is assumed that the full cost of the plan is supported by employer contributions. Further, it is assumed that both plans have identical participation standards and five year cliff vesting. It is assumed that a benefit once vested is truly vested. In the plans designed by the coverage study group it was assumed there would be post-retirement benefit indexation with rises in the Consumer Price Index.

The following discussion is based on some rather simple simulations that show benefit accruals under two pension plans. One is a defined benefit plan that provides 1.15 percent of the average high three consecutive years salary times years of service. The defined contribution plan provides an annual contribution of 14.5 percent of salary.

To show the accruals over time under the two plans the accruals of various hypothetical workers entering federal service at different ages and GS levels were simulated. The entry level positions chosen were at grades 1, 3, 5, 7, 9, 11 and 12. It was assumed that a 5 percent rate of inflation would persist throughout the simulation period. It was assumed that workers would enter federal employment on January 1, 1984 at salary rates in effect on January 1, 1983. This salary assumption is in accordance with the Reagan Administration proposal that federal salaries be frozen through 1983. The simulations assumed that real wages would grow at least 1 percent per year or as high as a 5 percent per year for the upper grade hires in their early years of federal employment. For purposes of calculating the value of accumulated contributions under the DC plan a real rate of return of 2 percent per year was assumed. A 2 percent real interest rate was also assumed for purposes of calculating the annual present values under the defined benefit plan.

Because of the volume of paper that would be involved in presenting all

the results only those from the GS-7 and GS-9 entrants are presented. Anyone wanting copies of the other results can obtain them from the author.

Figures 1 and 2 show the results of the first simulation that was done. In this case we assumed the worker began work on his twenty-second birthday and works forty years until the eve of his sixty-second birthday. He retires at age 62 and is expected to live 18 years. The path of asterisks in the figures represent the accumulated value of contributions at the end of each year of service beyond the date of vesting. The path of ampersands shows the present value of lifetime retirement benefits at the end of each year. From a practical standpoint it makes little difference which plan type is used in this instance because both accumulate comparable benefit values for the full 40 year worker.

However, the two paths also reflect the accumulation of 22 year old entrants who leave federal service after vesting but prior to attaining age 62. Certainly under the posited assumptions such individuals would leave federal service with a larger accumulation under the DC than DB plan during their early and mid-career years. Not only is the value of the accumulation higher, it is also portable (i.e., it can be cashed out). If the retirement plan is merely a savings vehicle for individuals starting a savings program early in their career, then the DC plan is probably superior under the posited assumptions. If the plan is to provide retirement income, however, then monies cashed out of the DC plan have to be rolled into an alternative retirement account. The prevalence with which such DC cash outs become effective elements in worker's ultimate retirement portfolios is unknown. It is a sure bet, however, that there is considerable leakage of those cash outs into

preretirement consumption.

There is also the possibility that everyone does not realize the consistent 2 percent real rates of return that were assumed in the derivation of these estimates. For example, if the real interest accruing to the DC fund parallels real rates paid on U.S. Government securities with three year maturities since 1960 then the outcome would be somewhat different than under the posited assumptions. In fact, both the GS 7 and 9 entrants would have a 10 to 11 percent smaller accumulation than shown in figures 1 and 2. The value of benefits in the DB plan would substantially exceed the DC accumulation in the latter case. There would still be a substantial period over which the DC accumulation would exceed the value of DB benefits, however. Before jumping to the conclusion that the DC option is superior to the DB plan for all but the very long service worker, alternative tenures should also be considered.

In the second set of simulations, individuals entering federal service at age 25 and reaching retirement eligibility with 30 years of service at age 55 were considered. The same entry level salary, wage growth and discounting assumptions were used as in the baseline simulation. In this instance, the individual who stays until retirement comes out significantly better off (by 25-35 percent) under the DB plan as shown in figures 3 and 4. It is the calculation process, actually the interest compounding over an extremely long period, that makes the DC plan more competitive with the DB plan up until retirement in the 40 year career case.

Additional simulations were run for individuals entering federal service in mid career and retiring at age 60 with 20 years of service. The results for the two hypothetical workers being discussed are shown in figures 5 and 6. Finally, the late entry workers who work only 10 years and retire at

age 62 are shown in figures 7 and 8.

CONCLUSIONS

On the basis of figures 1 through 8 certain conclusions can be drawn. The individual who is covered by a DC plan early in his career and stays with the employer 10 - 15 years receives larger benefits than if covered by a comparably expensive DB plan. It is not clear that these DC benefits are necessarily devoted to retirement income security but they will generally be larger than the benefits provided by the DB plan for the short termers early in his or her career. For the individual who enters later in his or her career and stays until retirement, the defined benefit plan considered here provides superior protection.

Furthermore, the analysis here assumed certain rates of return on assets that may not prevail in actuality. If they do not there may be lower benefit accumulations under the DC plan than expected. It is the individual worker who has to face the risk of that possibility. There is an upside to that risk, however, namely that rates of return may exceed those assumed here. In the case of the DB plan there is also a certain risk -- that being that the employer will be unable to support the plan at some future point in time. Among private plans this is primarily the risk of business failure and has been addressed to a certain extent by the PBGC. In the federal plan it is not economic risk as much as political risk that faces the DB plan participants.

The questions posed by the different benefit structures inherent in defined benefit and defined contribution plans give all the parties concerned about federal retirement much to ponder. Neither the DB nor DC plan is perfect to meet everyone's goals. To make matters even more confusing the options that will be discussed in coming months may look considerably different than those

analyzed here. The differences in the options may lead to somewhat different conclusions than this analysis.

As the discussion evolves and the legislation development begins everyone should understand that there are good reasons for and against both plan types. That, more than any other reason, may account for the fact that most large employers in the United States today have both a defined benefit and defined contribution plan for their workers.

Figure 1
ACCUMULATED BENEFITS AND PRESENT VALUE OF BENEFITS BY YEAR
FOR A HYPOTHETICAL FEDERAL WORKER HIRED AT THE GS-7 LEVEL ON JANUARY 1,
1984, WHO WORKS A 40 YEAR CAREER AND RETIRES AT AGE 62.

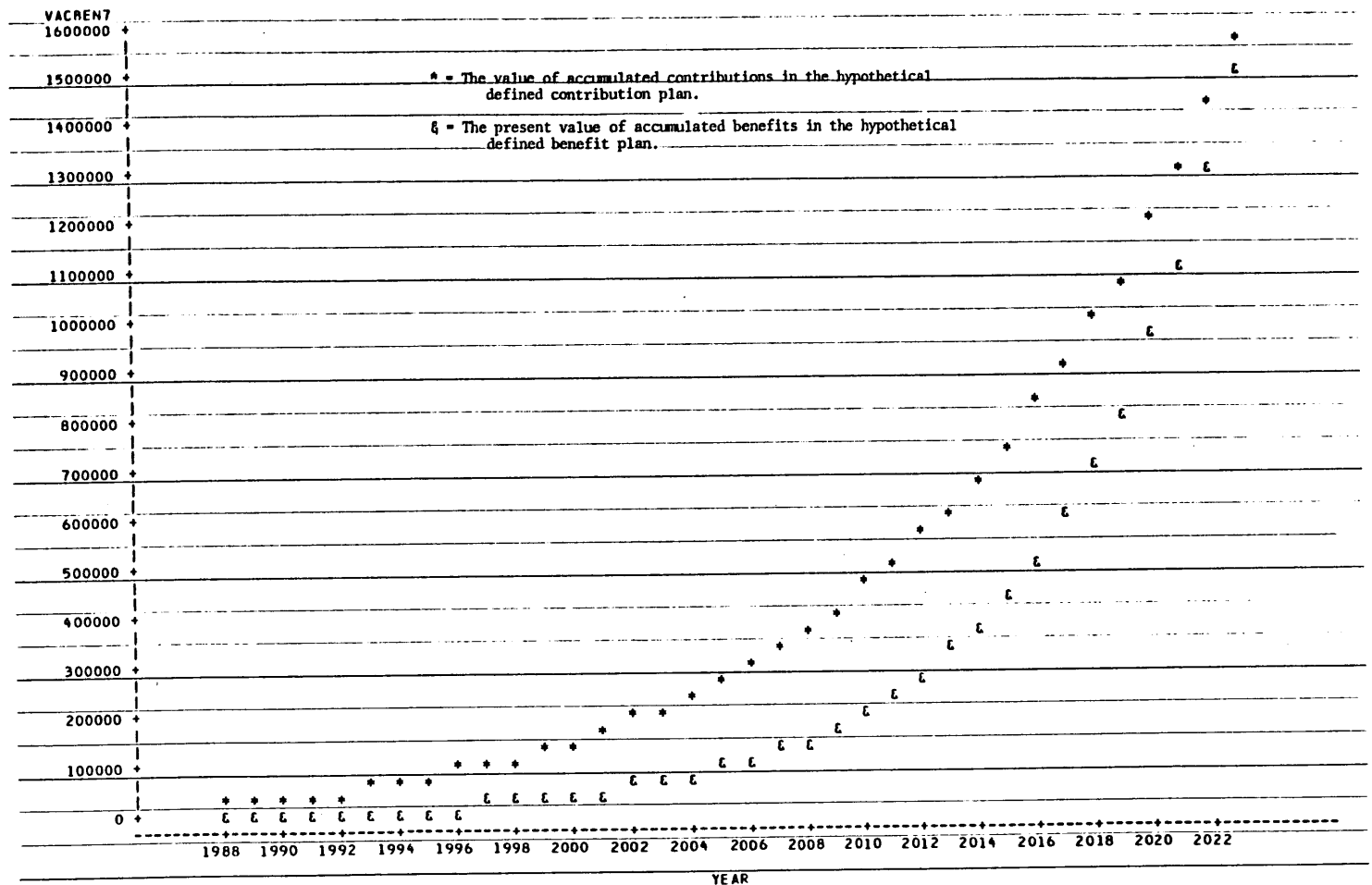


Figure 3
ACCUMULATED BENEFITS AND PRESENT VALUE OF BENEFITS BY YEAR
FOR A HYPOTHETICAL FEDERAL WORKER AT THE GS-7 LEVEL ON JANUARY 1,
1984, WHO WORKS A 30 YEAR CAREER AND RETIRES AT AGE 55

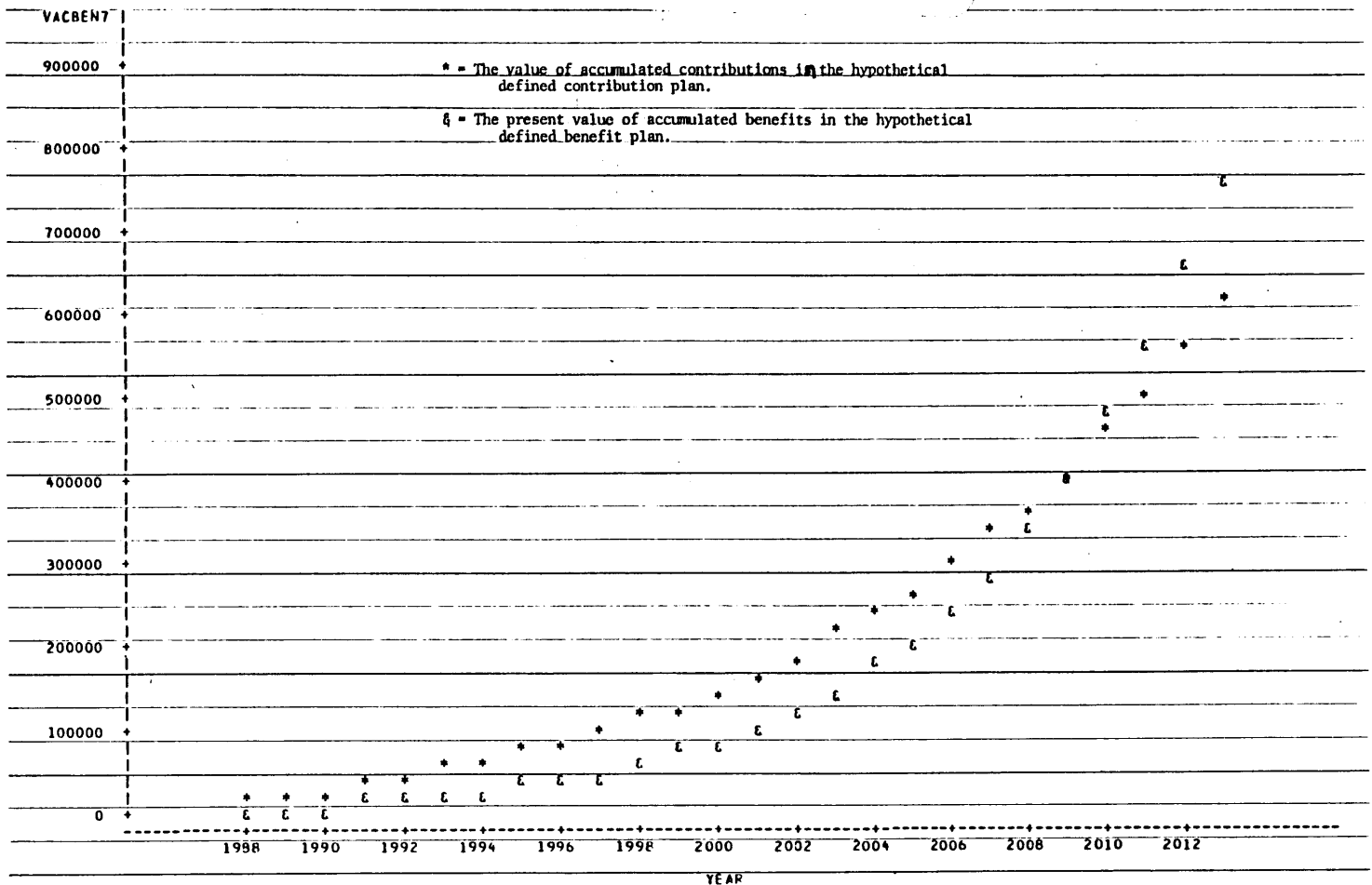


Figure 2
ACCUMULATED BENEFITS AND PRESENT VALUE OF BENEFITS BY YEAR
FOR A HYPOTHETICAL FEDERAL WORKER HIRED AT THE GS-9 LEVEL ON JANUARY 1,
1984, WHO WORKS A 40 YEAR CAREER AND RETIRES AT AGE 62

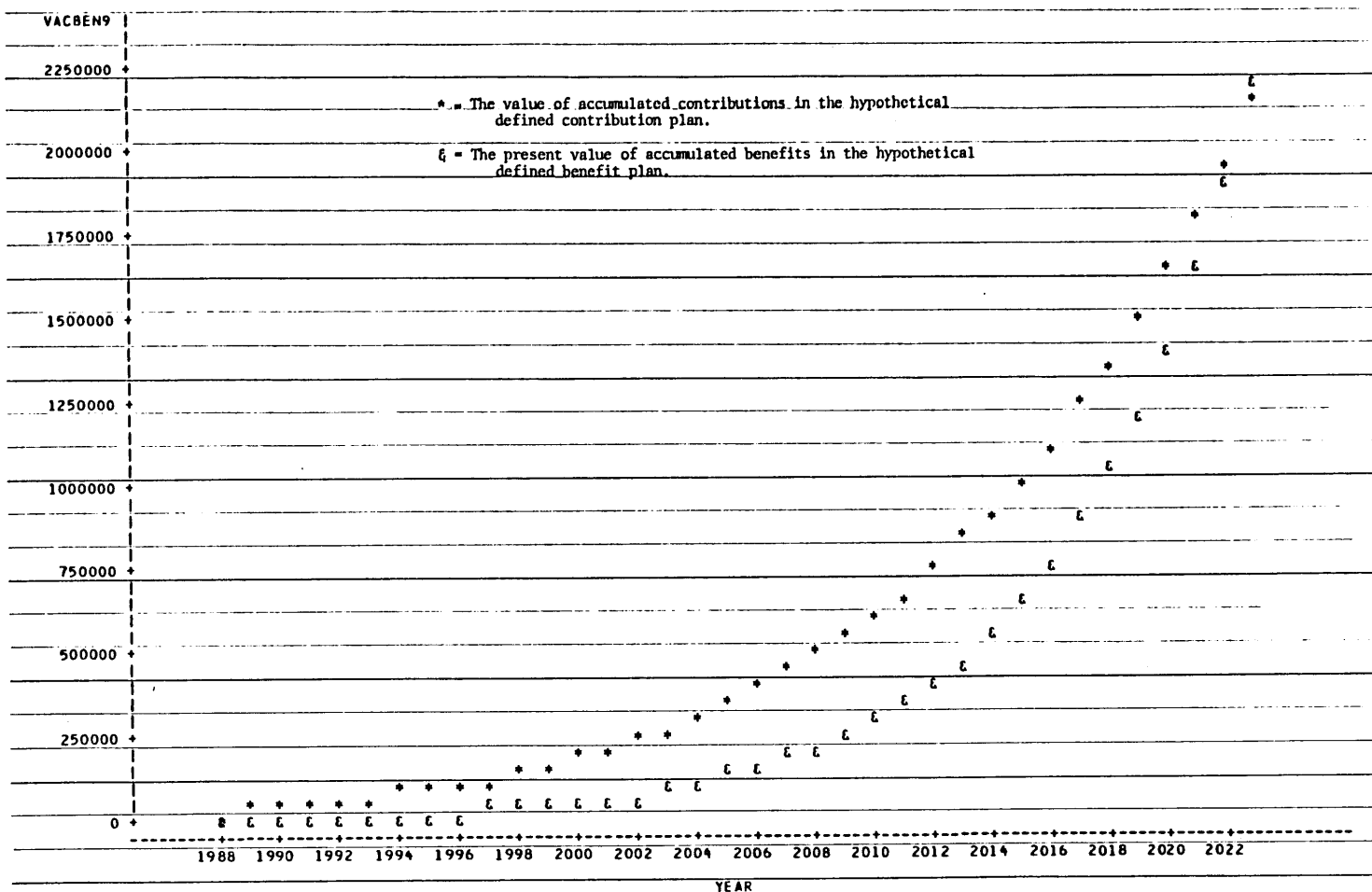


Figure 4
ACCUMULATED BENEFITS AND PRESENT VALUE OF BENEFITS BY YEAR
FOR A HYPOTHETICAL FEDERAL WORKER AT THE GS-9 LEVEL ON JANUARY 1,
1984, WHO WORKS A 30 YEAR CAREER AND RETIRES AT AGE 55

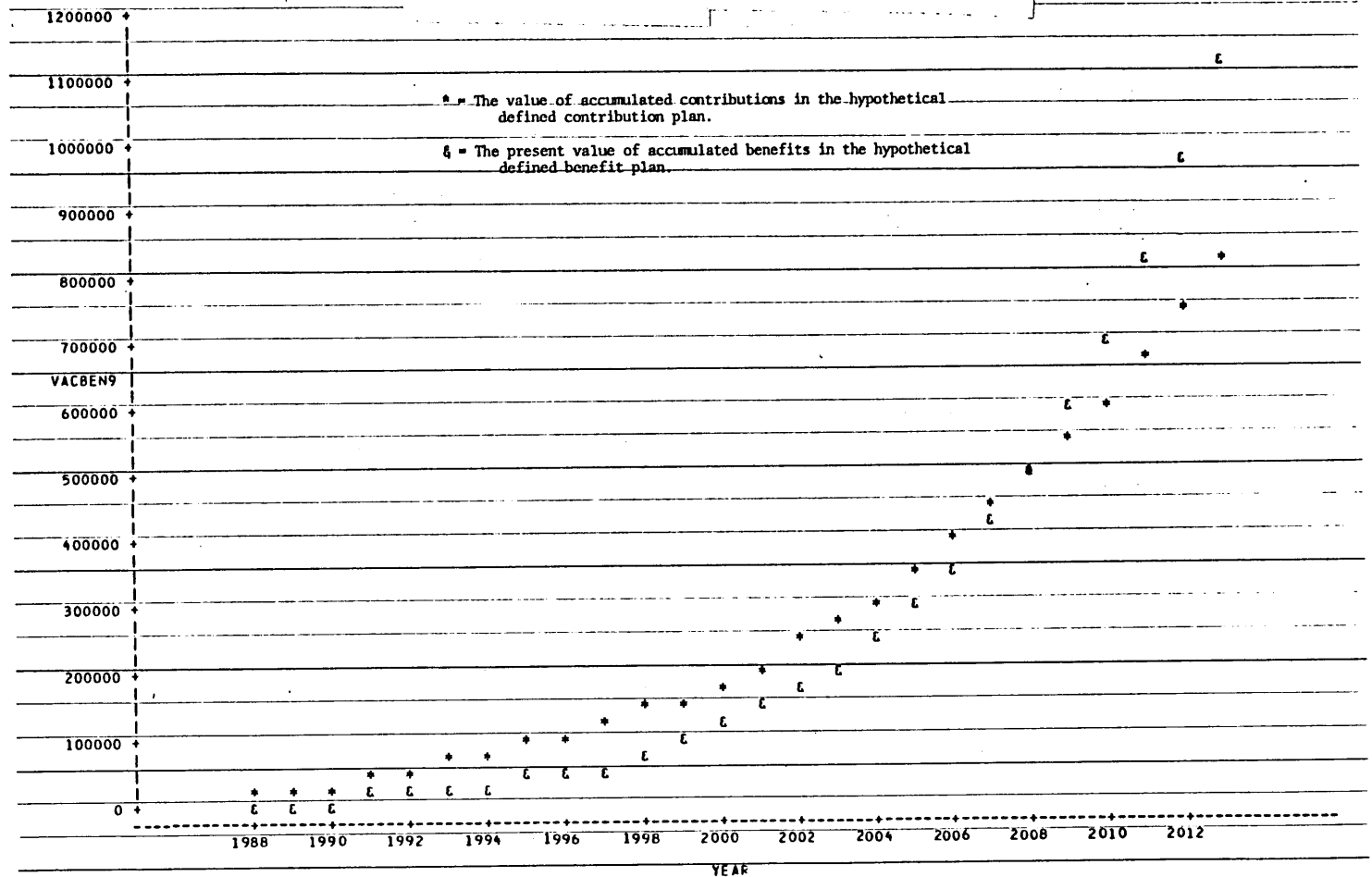


Figure 5
ACCUMULATED BENEFITS AND PRESENT VALUE OF BENEFITS BY YEAR
FOR A HYPOTHETICAL FEDERAL WORKER HIRED AT THE GS-7 LEVEL
ON JANUARY 1, 1984, WHO WORKS 20 YEARS AND RETIRES AT AGE 60

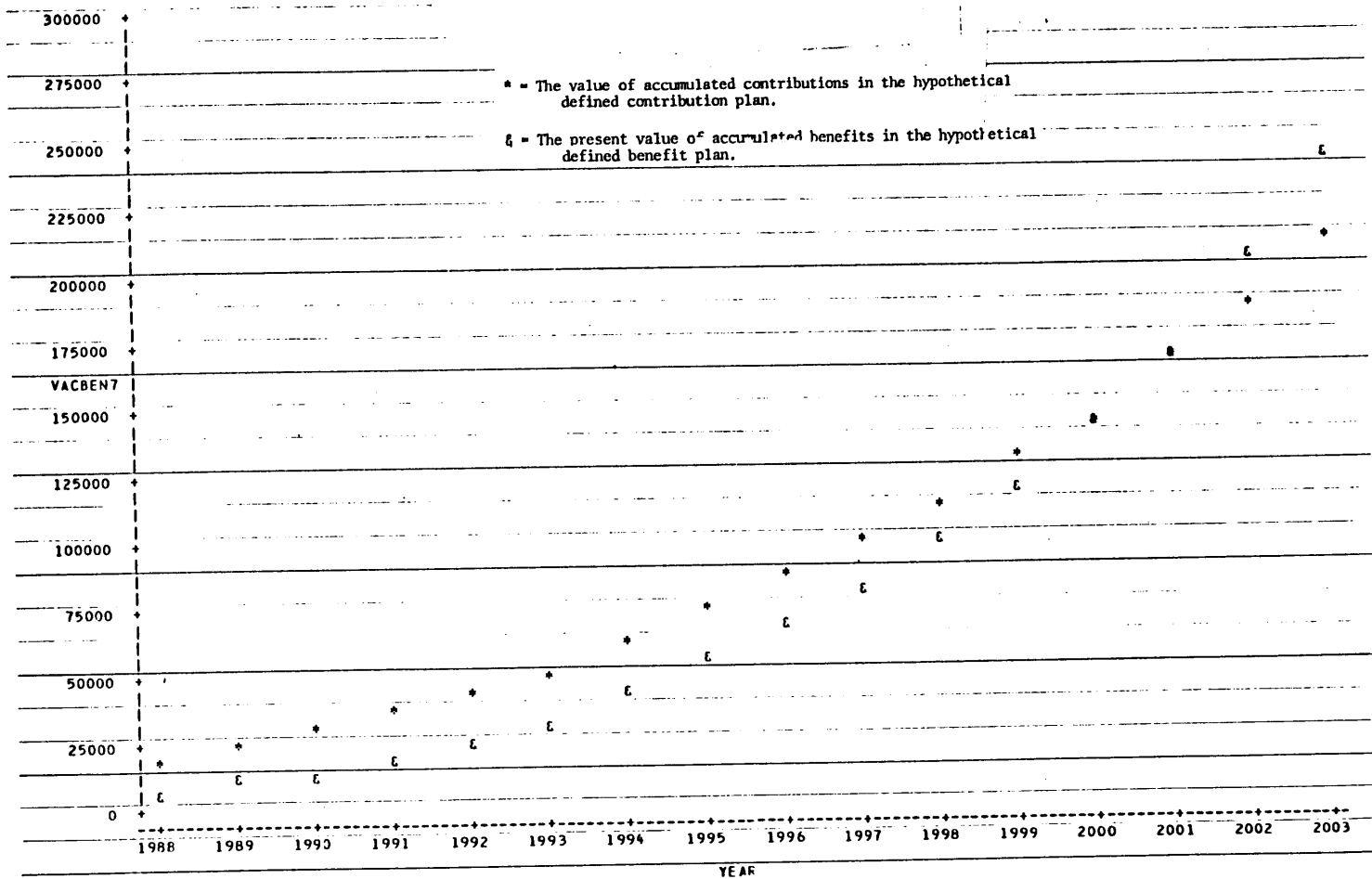


Figure 6
ACCUMULATED BENEFITS AND PRESENT VALUE OF BENEFITS BY YEAR
FOR A HYPOTHETICAL FEDERAL WORKER HIRED AT THE GS-9 LEVEL
ON JANUARY 1, 1984, WHO WORKS 20 YEARS AND RETIRES AT AGE 60

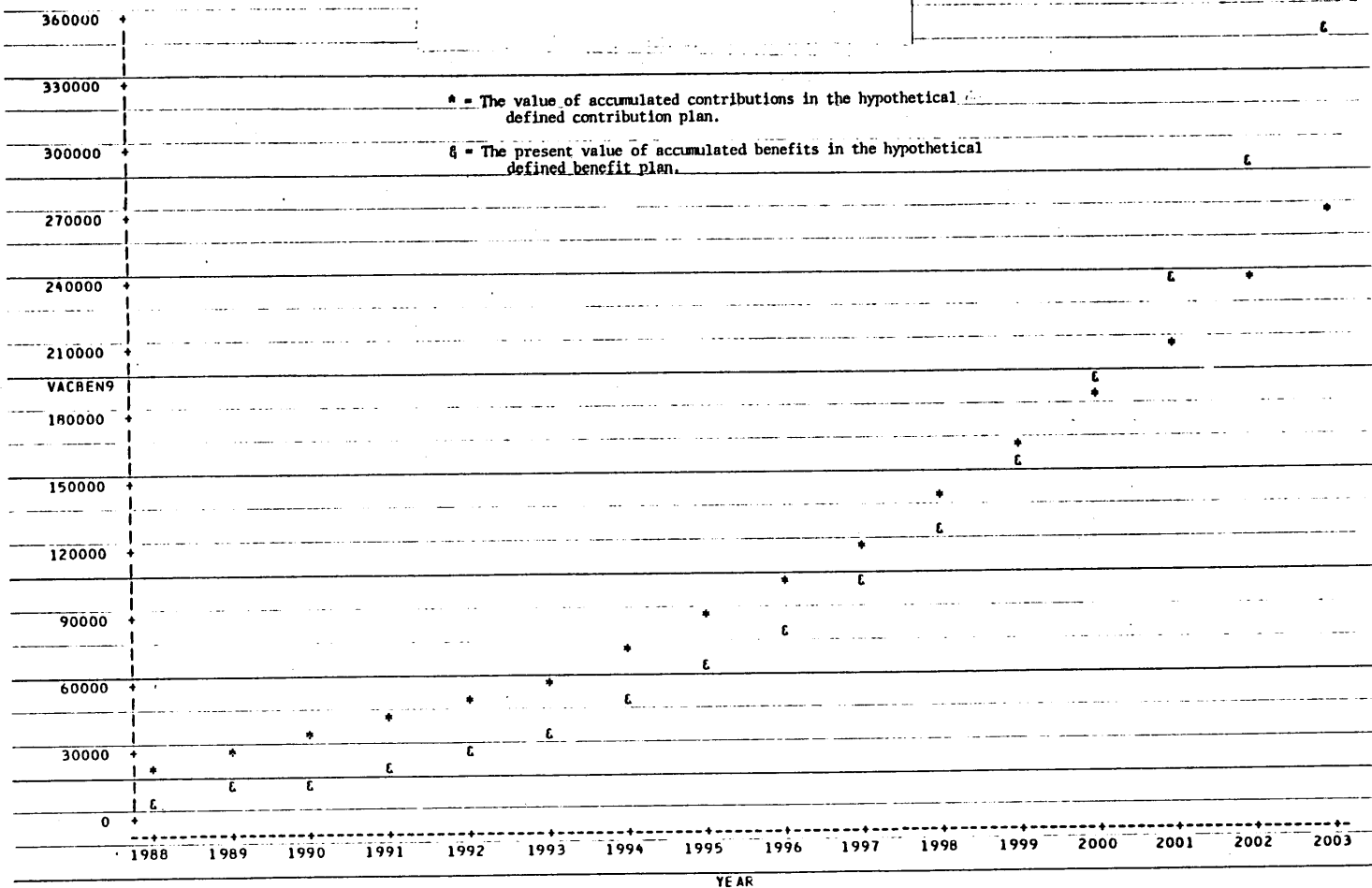


Figure 7
ACCUMULATED BENEFITS AND PRESENT VALUE OF BENEFITS BY YEAR
FOR A HYPOTHETICAL FEDERAL WORKER HIRED AT THE GS-7 LEVEL
ON JANUARY 1, 1984, WHO WORKS 10 YEARS AND RETIRES AT AGE 62

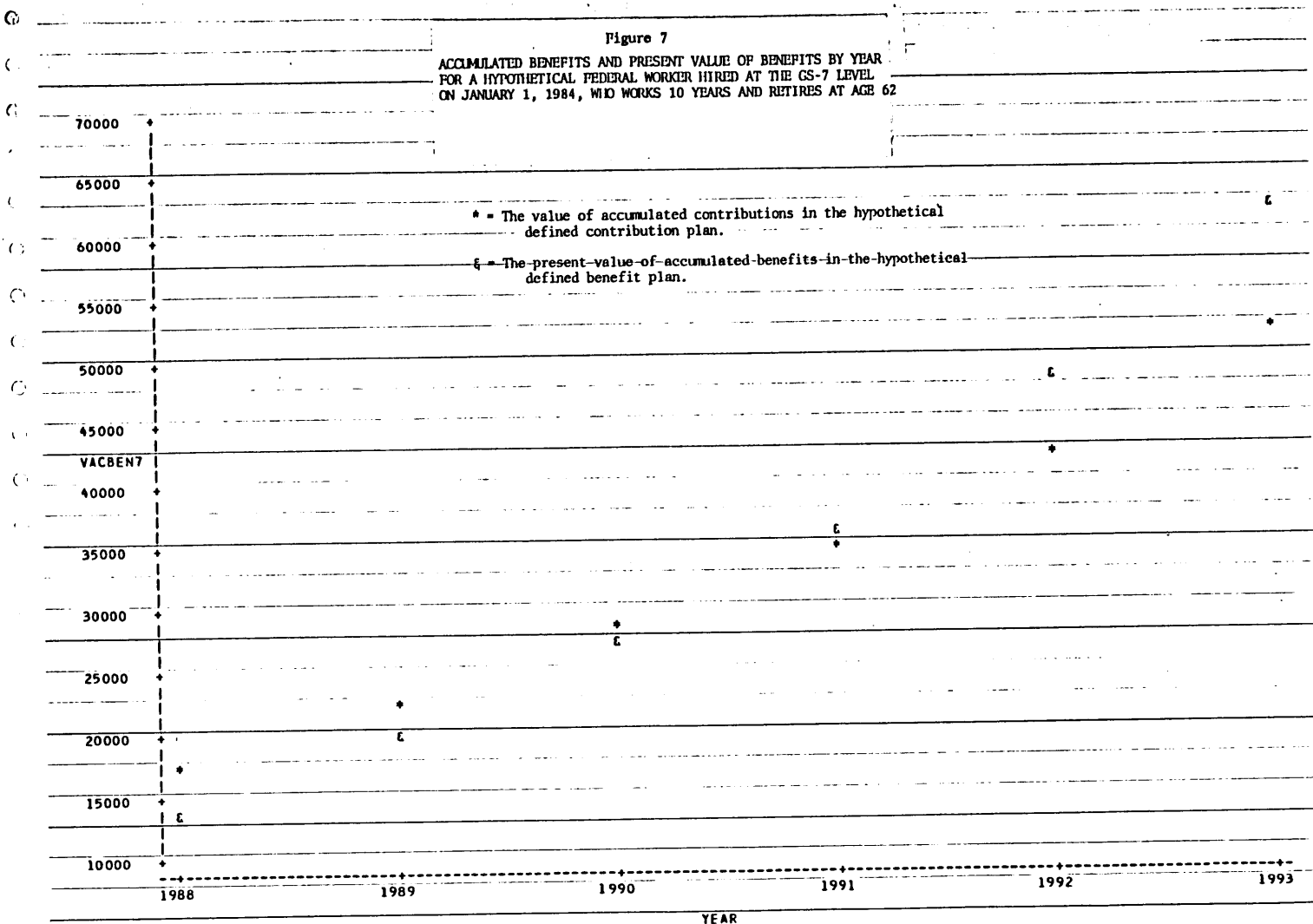
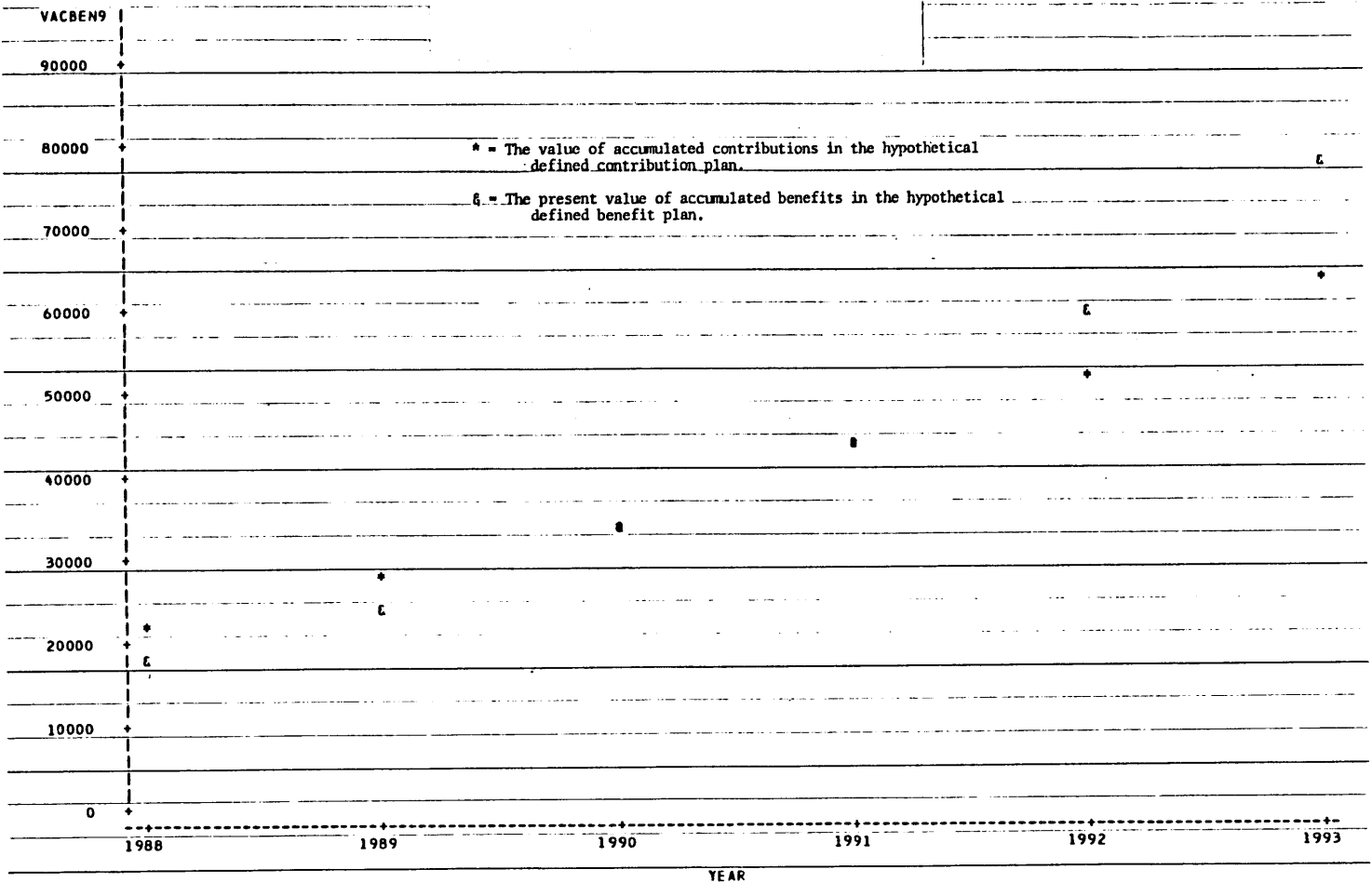


Figure 8
ACCUMULATED BENEFITS AND PRESENT VALUE OF BENEFITS BY YEAR
FOR A HYPOTHETICAL FEDERAL WORKER HIRED AT THE GS-9 LEVEL
ON JANUARY 1, 1984, WHO WORKS 10 YEARS AND RETIRES AT AGE 62



House of Representatives

Committee on Post Office and Civil Service

Washington, D.C. 20515

TELEPHONE (202) 225-4054

OPENING STATEMENT

CONGRESSWOMAN MARY ROSE OAKAR, CHAIR

SUBCOMMITTEE ON COMPENSATION AND EMPLOYEE BENEFITS

HEARINGS ON H.R. 4599 AND H.R. 5092

TUESDAY, APRIL 3, 1984

THE SUBCOMMITTEE ON COMPENSATION AND EMPLOYEE BENEFITS WILL
COME TO ORDER.

TODAY, THE SUBCOMMITTEE WILL BEGIN A SERIES OF HEARINGS ON
H.R. 4599, THE FEDERAL PAY EQUITY ACT OF 1984, AND H.R. 5092, THE
PAY EQUITY ACT OF 1984. TWO DAYS OF HEARINGS WILL BE HELD IN
WASHINGTON, D. C. I WILL COMPLETE THE SERIES IN FIELD HEARINGS
THROUGHOUT THE COUNTRY DURING THE SUMMER. I AM PLEASED TO HAVE
SO MANY FINE WITNESSES APPEARING TODAY AND ANXIOUSLY AWAIT YOUR
TESTIMONY.

IN THE FALL OF 1982, I WAS FORTUNATE ENOUGH TO CO-CHAIR WITH
CONGRESSWOMEN PATRICIA SCHROEDER AND GERALDINE FERRARO, THE FIRST
CONGRESSIONAL HEARINGS ON PAY EQUITY. DURING THOSE HEARINGS, WE
CONFIRMED THAT SEX-BASED WAGE DISCRIMINATION IS PERVASIVE IN THE

PRIVATE AND PUBLIC SECTORS. WITNESSES AT THE HEARINGS URGED THAT IN ORDER TO ELIMINATE THESE DISCRIMINATORY PRACTICES, THE FEDERAL GOVERNMENT NEEDS TO BE AGGRESSIVE IN ENFORCING THE CURRENT LAWS. WE WERE, IN FACT, PROMISED INCREASED ENFORCEMENT EFFORTS BY ADMINISTRATION OFFICIALS.

UNFORTUNATELY, SINCE THAT TIME IT APPEARS THAT THE ADMINISTRATION HAS FAILED TO KEEP FAITH WITH THE WORKING WOMEN OF THIS COUNTRY. WHILE VIGOROUS LITIGATION AND BARGAINING EFFORTS ARE BEING PURSUED BY SEVERAL MAJOR UNIONS, AND STATE AND LOCAL GOVERNMENTS CONTINUE TO EXAMINE THEIR PAY STRUCTURES FOR DISCRIMINATION AGAINST WOMEN, THE FEDERAL GOVERNMENT IS NOW DOING NOTHING. IN FACT, THE ADMINISTRATION MAY MOVE FROM BENIGN NEGLECT TO ACTIVE OPPOSITION WITHIN THE WEEKS AHEAD BY FORMALLY CASTING ITS LOT IN FEDERAL COURT WITH VOCAL OPPONENTS TO PAY EQUITY.

THE EQUAL PAY ACT OF 1963 PROHIBITS AN EMPLOYER FROM PAYING A WOMAN LESS THAN A MAN IF THEY ARE PERFORMING THE SAME JOB--WHICH REQUIRES EQUAL SKILL, EFFORT, AND RESPONSIBILITY. SIMILARLY, THE CIVIL RIGHTS ACT OF 1964 (TITLE VII) PROHIBITS EMPLOYERS FROM PAYING WOMEN LOWER WAGES EVEN WHEN JOB CONTENT DIFFERS.

EVEN THOUGH THESE LAWS ARE 20 YEARS OLD, WOMEN STILL AVERAGE 40 PERCENT LESS IN EARNINGS THAN MEN. IN 1939, WOMEN EARNED 63.06 CENTS FOR EVERY DOLLAR EARNED BY MEN. IN 1950, THIS DROPPED TO 62 CENTS AND HAS REMAINED AT THAT LEVEL EVER SINCE.

IN A VERY REAL SENSE, WOMEN ARE GOING BACKWARD DESPITE THE COMMITMENT OF OUR NATION TO ELIMINATE DISCRIMINATION IN ALL FACETS OF LIFE. FOR WOMEN IT'S A CATCH 22 SITUATION; LOW WAGES AS WORKERS TRANSLATE INTO EVEN LOWER SOCIAL SECURITY AND PENSION BENEFITS IN THEIR RETIREMENT YEARS.

TWO DECADES AFTER THE EPA AND CIVIL RIGHTS ACT, THE WAGE DIFFERENTIAL HAS REMAINED VIRTUALLY UNCHANGED DESPITE THE FACT THAT NEARLY HALF OF ALL BACHELORS AND MASTERS DEGREES ARE NOW EARNED BY WOMEN. BOTH BLACK AND WHITE WOMEN WHO ARE COLLEGE GRADUATES HAVE LOWER MEAN EARNINGS THAN WHITE MEN WITH EIGHTH GRADE EDUCATIONS.

IT IS STILL TRUE THAT THE MORE AN OCCUPATION IS DOMINATED BY WOMEN, THE LESS IT PAYS. THE AVERAGE ANNUAL SALARY FOR A SECRETARY IS NEARLY \$4,000 A YEAR LESS THAN A TRUCK DRIVER. PRIVATE HOUSEHOLD WORKERS, 95 PERCENT OF WHOM ARE WOMEN, EARN LESS THAN HALF OF WHAT IS PAID A JANITOR. AND MOST CHILD CARE WORKERS ARE PAID LESS THAN DOG POUND ATTENDANTS. OUR PETS SEEM TO BE MORE IMPORTANT THAN OUR CHILDREN. WHAT A SAD COMMENTARY FOR THE FUTURE OF OUR COUNTRY.

NOT ONLY ARE WOMEN CLUSTERED IN LOW-PAYING OCCUPATIONS, ACCORDING TO A REPORT OF THE NATIONAL ACADEMY OF SCIENCE, THEY ARE MORE LIKELY THAN MEN TO BE EMPLOYED IN LOW-PAYING FIRMS. THIS CLUSTERING IS ALSO TRUE OF OUR FEDERAL GOVERNMENT.

IN ADDITION, 90 PERCENT OF ALL SINGLE PARENTS ARE WOMEN, 35 PERCENT OF WHOM FALL BELOW THE POVERTY LEVEL. FIFTY-THREE PERCENT OF ALL WOMEN NOW WORK, AN INCREASE OF 30 PERCENT SINCE 1950. FURTHERMORE, WOMEN WHO MAINTAIN FAMILIES AVERAGE \$10,000 A YEAR, WHILE TWO-EARNER COUPLES EARN APPROXIMATELY \$28,000.

WHY DOES THE WAGE GAP PERSIST BETWEEN MEN AND WOMEN? IS IT SIMPLY THAT WOMEN'S WORK IS VALUED LESS THAN MEN'S? IS THE LAW INADEQUATE IN PROTECTING WOMEN WORKERS? OR, IS THE ISSUE OF PAY DISCRIMINATION MISUNDERSTOOD?

PART OF THE REASON THAT SEX-BASED WAGE DISCRIMINATION EXISTS, DESPITE CURRENT LAW, IS THAT WOMEN REMAIN IN TRADITIONALLY FEMALE DOMINATED OCCUPATIONS. EIGHTY-ONE PERCENT OF CLERICAL WORKERS, 96 PERCENT OF NURSES, AND 82 PERCENT OF ELEMENTARY SCHOOL TEACHERS ARE WOMEN. IN MY OPINION, TEACHERS, NURSES, AND CLERICAL WORKERS ARE PAID LESS BY VIRTUE OF THEIR GENDER AND THEIR ROLES IN SOCIETY, AND NOT BECAUSE THEIR OCCUPATIONS ARE OF LESS VALUE TO OUR NATION.

SOME WOULD ARGUE THAT BY OPENING CAREER OPPORTUNITIES FOR WOMEN IN TRADITIONALLY MALE DOMINANT JOBS, WAGE DISCRIMINATION WILL EVENTUALLY DISAPPEAR. BUT THE JOBS WOMEN PERFORM ARE ESSENTIAL TO OUR SOCIETY. WE, OUR CHILDREN, AND OUR SENIOR CITIZENS NEED QUALITY HEALTH CARE. THE FUTURE OF OUR COUNTRY IS DEPENDENT UPON OUR EDUCATIONAL SYSTEM. RATHER THAN SIMPLY DECLARING VICTORY WHEN WOMEN ATTORNEYS ARE EQUAL IN NUMBER TO

MEN, WE NEED TO REEXAMINE "WOMEN'S WORK" AND ESTABLISH THE TRUE VALUE FOR THESE OCCUPATIONS. WE NEED TO ATTACK SEX-BASED WAGE DISCRIMINATION WITH THE SAME SPIRIT AND COURAGE AS THE "FREEDOM RIDERS" OF A GENERATION AGO.

UNION ACTIVITY THROUGH COLLECTIVE BARGAINING AND LITIGATION HAS PROVEN EFFECTIVE IN ELIMINATING PAY INEQUITY. BUT THIS IS A COSTLY PROCESS AND NOT AVAILABLE TO EVERY WOMAN WORKER. STATE AND LOCAL GOVERNMENTS ARE ALSO BEGINNING TO LOOK AT THEIR OWN PAY STRUCTURES TO DETERMINE WHETHER SEX-BASED WAGE DISCRIMINATION EXISTS. WE CAN ALL APPLAUD AND FIND ENCOURAGEMENT IN THE RECENT COURT DECISION IN THE STATE OF WASHINGTON.

CORPORATIONS ARE ALSO STARTING TO VOLUNTARILY EXAMINE THEIR PAY PRACTICES. ONLY THE FEDERAL GOVERNMENT IS STANDING MUTE. WHILE MINNESOTA, CONNECTICUT, AND SOME CITIES IN CALIFORNIA ARE TAKING AFFIRMATIVE ACTION TO ELIMINATE WAGE DISCRIMINATION IN VARIOUS OCCUPATIONS, THIS ADMINISTRATION SEEMS TO BE DEVOTING ITS ENERGY TO DEFINING TERMS--NOT TO ENFORCING THE PRESENT LAWS.

MEMBERS OF CONGRESS ON BOTH SIDES OF THE AISLE HAVE INTRODUCED LEGISLATION IN REACTION TO THE FEDERAL GOVERNMENT'S LACK OF COMMITMENT, IF NOT OUTRIGHT OPPOSITION, TO PAY EQUITY. I AM A FIRM BELIEVER THAT THE LAWS WHICH ARE IN PLACE PROVIDE ADEQUATE PROTECTION TO EMPLOYEES. THE LEGISLATION I HAVE INTRODUCED ILLUSTRATES THAT BELIEF.

THE ADMINISTRATION SHOULD BE AN ADVOCATE OF PAY EQUITY, BUT IT IS JUST THE OPPOSITE. INSTEAD OF ENFORCING THE LAW, IT IS THWARTING IT. MY LEGISLATION WOULD REQUIRE THE ADMINISTRATION TO FULFILL ITS ENFORCEMENT DUTIES. ONE BILL, H.R. 4599, MANDATES THE OFFICE OF PERSONNEL MANAGEMENT TO STUDY AND IDENTIFY THE WAGE DISCREPENCIES IN THE FEDERAL CLASSIFICATION STRUCTURE AND TO DEVISE A MORE EQUITABLE JOB EVALUATION PROGRAM. IF SUCCESSFUL, THE FEDERAL STRUCTURE SHOULD PROVIDE A WORKING EXAMPLE TO THE PRIVATE SECTOR AND THE STATES.

MY SECOND BILL WOULD REQUIRE PERIODIC, DETAILED REPORTS TO THE PRESIDENT AND CONGRESS BY THE EQUAL EMPLOYMENT OPPORTUNITY COMMISSION, THE ATTORNEY GENERAL, AND THE DEPARTMENT OF LABOR DESCRIBING THE ACTIONS TAKEN BY THESE AGENCIES TO ENFORCE FEDERAL LAWS PROHIBITING WAGE DISCRIMINATION. IT IS NO SECRET THAT THE EEOC'S ACTIVITY, IF I CAN EVEN USE THAT TERM, LEAVES MUCH TO BE DESIRED. IT SEEMS THAT THE ONLY REAL ACTIVITY AT THIS AGENCY IS TRACKING ITS GROWING INVENTORY OF UNPROCESSED SEX-BASED WAGE DISCRIMINATION CHARGES. IT IS MY HOPE THAT THIS WILL SOON CHANGE AND THAT THE LEGISLATION I AM SPONSORING WILL PROMPT THE FEDERAL GOVERNMENT TO TAKE A HARD, SERIOUS LOOK AT PAY EQUITY--THAT THIS ADMINISTRATION WILL FINALLY BEGIN TO FULFILL ITS STATUTORY RESPONSIBILITIES.

FOR THE RECORD, I DO WANT TO POINT OUT THAT THE PRESIDENT, AND OFFICIALS FROM THE JUSTICE DEPARTMENT AND THE LABOR DEPARTMENT, WERE INVITED TO PARTICIPATE IN THESE HEARINGS. THE

PRESIDENT DECLINED OUR INVITATION AND JUSTICE AND LABOR REFUSED TO SEND WITNESSES. SAD AS IT IS TO SAY, THEIR SILENCE IS ILLUSTRATIVE OF THE INATTENTION THAT THIS ADMINISTRATION HAS GIVEN TO AN ISSUE THAT AFFECTS EVERY WOMAN IN THIS COUNTRY.

AGAIN, I WELCOME ALL THE WITNESSES AND LOOK FORWARD TO THEIR TESTIMONY.

House of Representatives

Committee on Post Office and Civil Service

Washington, D.C. 20515

TELEPHONE (202) 225-4054

SUBCOMMITTEE ON COMPENSATION AND EMPLOYEE BENEFITS

HEARING ON H.R. 4599 AND H.R. 5092

TUESDAY, APRIL 3, 1984

LIST OF WITNESSES

THE HONORABLE MICHAEL D. BARNES (D-MD)

THE HONORABLE STENY H. HOYER (D-MD)

THE HONORABLE MARCY KAPTUR (D-OH)

THE HONORABLE BARBARA A. MIKULSKI (D-MD)

THE HONORABLE PATRICIA SCHROEDER (D-CO)

~~MRS. LEE HART~~ (MARTHA KEYS)
REPRESENTING THE HONORABLE GARY HART (D-CO)

MRS. JACQUELINE JACKSON
REPRESENTING THE REVEREND JESSE JACKSON

MRS. JOAN MONDALE
REPRESENTING THE HONORABLE WALTER F. MONDALE
(ACCOMPANIED BY GLENNIS TER WISSCHA)

- 2 -

PANEL: MS. MARY FUTRELL, PRESIDENT
NATIONAL EDUCATION ASSOCIATION

MR. JOHN SWEENEY, PRESIDENT
SERVICE EMPLOYEES INTERNATIONAL UNION, AFL-CIO

MS. JUDY GOLDSMITH, PRESIDENT
NATIONAL ORGANIZATION FOR WOMEN

PANEL: MS. NANCY REDER, CHAIR
NATIONAL PAY EQUITY COMMITTEE

DR. QUINCALEE BROWN, EXECUTIVE DIRECTOR
AMERICAN ASSOCIATION OF UNIVERSITY WOMEN

MS. FLORINE KOOLE, ASSISTANT TO THE EXECUTIVE VICE PRESIDENT
COMMUNICATIONS WORKERS OF AMERICA

THE HONORABLE DONALD J. DEVINE, DIRECTOR
U. S. OFFICE OF PERSONNEL MANAGEMENT

MS. SONIA JOHNSON
CANDIDATE FOR PRESIDENT, CITIZENS PARTY